TAXATION

ITS INCIDENCE AND EFFECTS

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PREFACE

When, in the course of a decade or so, the national and local budgets increase in proportion from one-eighth to one-quarter of the total income of the people, it is but natural that the citizens should become less apathetic to fiscal matters. Whatever may be said against the present huge exactions, they have at least had the salutary effect of stimulating an almost unprecedented interest in the economics of public revenue and expenditure.

The newcomer to the study of public finance, however, may not find it easy to steer a straight course through the complexities of the subject. If his new interest springs from a sense of grievance against those in authority, he may find it particularly difficult to prevent his political views from colouring his economic conclusions. But, while public finance necessarily belongs to both departments of social study, it is preferable to begin with the economics rather than with the politics. Though the method may not be so exciting, the data are more certain and the reasoning more complete. It may even be dangerous to venture upon a political study, let alone upon the paths of a new policy, without some preliminary investigation into the likely repercussions on the economic system.

The reader who comes fresh to the subject is apt, moreover, to find it a little disconcerting when different authorities, whose opinion in their special spheres is widely respected, seem to be at variance on principles of public financial policy. Faced with this apparent conflict (which turns out, more often

than not, to be but a question of emphasis) he is liable to be a little bewildered, and possibly, as a result, a little sceptical of the teaching of economics on such matters

It is in the hope of assisting the student and the general reader to get a clear view of the main aspects of the fiscal problem that this book is written Though the subject is in parts highly controversial, the following chapters are not intended to advocate or to attack any particular cause Their aim is to discuss in impartial terms the incidence and effects of national and local taxation, and to make the argument intelligible to those who are unversed in economic science For the benefit of those who wish to enter more deeply into the various problems several references and an annotated bibliography are provided

Parts of this work have appeared in *Taxation*, *The Accountant*, *The Certified Accountants' Journal*, and *The Incorporated Secretaries' Journal*, and are reproduced, in modified and extended form, by the courtesy of the editors The table (Appendix XII), reducing tax revenue to terms of purchasing power, is reprinted from *British Budgets, 1913–1921*, by the kind permission of Sir Bernard Mallet and Mr C O George, and of the publishers, Messrs Macmillan & Co Most of the chapters were read in draft form by Dr R F Rattray and Dr P W Bryan, both of whom offered most helpful suggestions, while Mr R C Couzens once again generously helped in the revision of the proofs For all this practical assistance the author tenders his deepest thanks

H A S

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CONTENTS

INTRODUCTION

PART I

GENERAL PRINCIPLES OF TAXATION

CHAPTER I

THE PURPOSE OF TAXATION

1. *The "Financial" and "Benefit" Theories*

2. *The "Socio-Political" Theories*

CHAPTER II

THE NATURE OF PUBLIC EXPENDITURE

1. *Private and Public Functions*

2. *The Classification of Public Expenditure*

3. *The Cost of the National Debt*

4 *The Cost of the Social Services*

CHAPTER III

Taxable Capacity and the National Income

CHAPTER IV

Equity and Economy in Taxation

1 *Ability to Pay*

2 *Progressive Taxation*

CHAPTER VIII

The Effects of the Income Tax

1. Conditions of Demand and Supply

CHAPTER IX

THE INCIDENCE OF THE DEATH DUTIES

1. *Relation of Death Duties to Income Tax*

CHAPTER XI

Commodity Duties

CHAPTER XII

Stamp Duties

3. *The Duty on Transfer of Stocks and Shares*

4. *The Duties on Conveyance, Cheques, and Receipts*

CHAPTER XIII

Land Taxes

CHAPTER XIV

National and Local Finance

1. *The Growth of Local Rates and Expenditure*

2. *National and Local Functions*

3. *National and Local Revenues*

CHAPTER XV

THE INCIDENCE OF LOCAL RATES

1. *Special Problems*

2. *Incidence on the Landowner*

3. *Incidence on the Building Owner*

CHAPTER XVI

LOCAL RATES AND INDUSTRY

CHAPTER XVII

THE CONCENTRATION OF TAXATION

2. *A Single Tax on Income*

APPENDIX

INTRODUCTION

§ 1 The considerable increase in public undertakings and expenditure in recent years has coincided with a marked set back to industrial prosperity Is the growth of national and local spending largely responsible for the depression, or are they both due to, and symptoms of, a deeper cause? On the one hand are the upholders of the Gladstonian belief that money left in the pockets of the private owners is used to better advantage, from the point of view of the community as well as of the individual, than if it has to pass through the public purse They contend that, until there is a ruthless limitation of the spending departments, the economic situation cannot be healthily restored On the other hand are those who, while admitting that the exceptional times have entailed an abnormal increase in certain types of expenditure, strongly deny that the growth of the public departments is in itself a cause of our economic difficulties Indeed, they might aver, had the expenditure of the usually criticised departments not gone up in response to the need, the economic position of the country would have been even worse than it is

§ 2 Obviously the questions are too wide to be answered in a few words, and the problems to which

they give rise will, in fact, take up a large part of the following chapters There are, however, one or two preliminary observations that may be made before we embark upon the main inquiry The common notion that all taxation is necessarily a burden should, from the start, be treated with reserve That the taxpayer himself feels the weight of the impost is only too painfully true, but there would be no taxes at all if individual sacrifice were the only deciding factor When people complain of the " burden of taxation ", however, they usually mean something more than the personal inconvenience entailed They may, for instance, believe that the volume of taxation is so great that it inflicts suffering on the nation as a whole Up to a point, they may allow, the benefit of the revenue and expenditure to the community in general is greater than the loss to its taxpayers in particular When that point has been passed, they say, the taxes become burdensome Or, approaching the subject from a different standpoint, they may submit that the weight of taxation is so heavy, or is so maladjusted, that it falls with undue severity on the producing sections of the nation, with adverse effects sooner or later on the standards of all classes

§ 3 No judgment, however, can be passed until certain important conditions are taken into account In the first place, it is necessary to know the character and composition of the public expenditure Some outlays are heavy, but partake of the nature of capital investments and can well be afforded Others, though in quantity they may be much smaller, may be unremunerative and be beyond the capacity of

the nation Thus, the mere size of the Budget is no criterion in itself of the real burden that is being imposed upon the taxpayers, and an increase in public expenditure, provided it is properly conceived and carried out, may be quite compatible with the economic welfare of the nation

The above proviso, however, is not always observed Much of our public expenditure owes its origin to emergency conditions, such as wars, that give no time or opportunity for calm deliberation over the pros and cons of the costs to be incurred Nearly a half of the revenue of the State goes to meet the charges of the National Debt, which is due almost in its entirety to wars of the past The needs of defence account for scores of millions which, under a happier system, would be employed for more useful ends And there are critics who maintain that our present social services are by no means immune from similar charges of unwise spending

In the second place it is necessary to know the nature and methods of the taxing system employed Raising a sum of money in one fashion may impose a heavier or a lighter burden on the taxpayers as a whole than obtaining the same amount by another system As will be repeatedly shown in the succeeding chapters, the problems of the "taxable capacity" of the nation, and of the effects on industry and commerce, depend largely on the criteria selected by the legislature and on the efficiency of the administration

§ 4 Some account of these conditions is a necessary preliminary to a discussion on the incidence and effects of taxation In dealing with *incidence* we wish to know on whom the money burden of a tax directly

or indirectly falls, to what extent the impost "stays put", and to what extent it is shifted Is it possible, for example, for a business man to pass on his income tax to his customers in the form of higher prices? Is it possible for a commodity duty to remain with the seller instead of being paid by the buyer? Such considerations have naturally an important bearing on the final distribution of taxation

But even more important from the point of view of economic welfare, is the question of ultimate *effects* Besides ascertaining, so far as possible, who bears the money burden of a tax, we want to know what are the economic reactions to which it gives rise The amount may be so oppressive, or the manner of imposition be so ill-conceived, that the taxpayer is discouraged from exercising his productive powers to the full The effect here is largely psychological Or so much may be taken from the yearly flow of income as to leave insufficient wealth for future capital needs, again prejudicing the productive capacity of the nation The effect here is mainly physical By pressing heavily at a relatively few points, the system of taxation may have profound effects upon the distribution of the country's income and wealth, which in turn may considerably affect both the volume and the nature of future production

Every tax, whatever may be the original motive, is bound to create a train of consequences The old view that taxation should be "for revenue only" was useful, in a rough and ready way, to distinguish it from the proposals that certain taxes should be specifically designed for protective, sumptuary, or

other purposes. But, literally interpreted, it might give the false impression that a tax can be utilised simply as a revenue-raising machine, without any effects, direct or otherwise, on the incentive and capacity of the individual taxpayers, and on the character of the economic organisation in general.

§ 5. Taxation, therefore, to be seen in its proper perspective, should be viewed from all these standpoints, and its effects should be judged over a reasonable period of time. The notion of a balance should be kept in mind, first, as between the total amount of taxation and the national income as a whole, and, secondly, as between the different types of expenditure. The ideal rule in both cases is to allocate the resources in such proportions as to secure the maximum social return. It is not pretended, of course, that the proportions are capable of exact determination, or that they can be fixed to suit all conditions. Wars and other emergencies may compel a country to use up a far greater amount of its resources than it can normally afford. A government may be driven by circumstances to increase its allowance to certain spending departments, at the expense of other departments whose claims may be no less important but not so urgent or insistent. The conception of a point of maximum social advantage is thus relative to prevailing circumstances, and is admittedly, in our present state of knowledge, more of theoretical than of practical significance. But that is no reason why, in the discussion of particular problems, the underlying and general principle should be lost sight of.

PART I

GENERAL PRINCIPLES OF TAXATION

CHAPTER I

THE PURPOSE OF TAXATION

1 The "Financial" and "Benefit" Theories

§ 1 There is a pronounced difference of opinion on the nature and purpose of public revenue and expenditure At the one extreme are those who are frankly apprehensive of many governmental activities, and would cut down the spending departments to the minimum that is consistent with national safety At the other extreme are those who, far from regarding taxation merely as a necessary evil, would deliberately use and extend it as a means of modifying the existing economic and social structure Between these opposed limits there is a wide range of views, which, at the outset of this inquiry, it will be useful to distinguish

The first, or the "financial", view is the simplest to understand, for it attributes no ulterior motive of any kind It is the view that would probably be expressed by the ordinary person who, until the question had suddenly been levelled at him, had never given the matter a moment's thought A tax is regarded as being nothing more than a means of providing the State with the funds that it requires

The objects of public expenditure do not directly enter into the question They are decided by the governing body, and the work of the Chancellor of the Exchequer is merely to obtain the necessary cash as effectively and expediently as possible The government may want to spend five millions on cruisers, or on education, or on old age pensions Whether the object be economically desirable or not, the character of the tax is held to remain the same It is merely a device for raising money, with as little inconvenience to the taxpayers as is practicable

The Chancellor, however, is apt to judge the degree of inconvenience by the strength of the outcry, and it is not always those who suffer the most who make the loudest protest In the absence of a more enlightened view of taxation, there is a danger lest the attitude of the revenue raising department should resolve itself into one of extracting most where the power of resistance is weakest, even though the method infringes the rule of equity From such a state of affairs all kinds of abuses may arise, and, in fact, did arise in the days before taxation and its purposes received serious thought

§ 2 The so called financial view of taxation is, in fact, no reasoned view at all Its limitations are too obvious for it to have any real significance at the present time The "benefit" theory, however, which has something in common with the first doctrine, has a greater element of truth in it, and is on that account more plausible A tax is regarded as a payment for and the measure of a service rendered by the State or local body to the individual taxpayer It resembles the financial

theory in that it pays no regard to the ethical and social implications of taxation and is therefore devoid of any reformist character. It differs from that theory in that it is not content with regarding the revenue as a whole, but attempts in some way to link up individual payments made and benefits received.

Little reflection is needed for one to realise the defects of the benefit theory and its inability, with a few exceptions, to fit the existing system of taxes. A man with £50,000 a year pays over 50 per cent in taxation, directly and indirectly, while a man with £1000 a year pays less than 15 per cent. Nobody would suggest that the man who pays the larger amount of tax receives a correspondingly greater measure of services from the State, or, for that matter, that the man with the comparatively modest £1000 a year specifically receives in value anything approaching the amount he is called upon to pay. But if we take incomes at the other end of the scale, say between £100 and £500, we find that there is not the same discrepancy between payment and benefit; and in the smallest income ranges the money value of the public services received outweighs, on the average, the amount of taxation that has to be paid.[1]

§ 3. In particular forms of taxation, however, the element of benefit still lingers. For example, the Road Fund was established some years ago with the express intention of spending the whole of the motor vehicle duty on road construction and maintenance. Later on, when the revenue from this source proved more plentiful than had been anticipated, the

[1] See below, pp. 44-45.

Chancellor of the Exchequer decided to divert all the proceeds over a certain amount to the general purposes of the State From the point of view of the motorist, who had been promised that the total revenue from this source would be expended on roads, this was a breach of faith But the main fault lay, perhaps, not with the Chancellor who decided to raid the fund, but with those who were originally responsible for creating this kind of vested interest It is true that motorists as a class derive special advantage from good roads, but the benefit is by no means confined to them alone Road transport, both of passengers and of goods, affects the welfare of every class of citizen, whether he personally pays the duty or not

The submission that the amount of duty is graduated according to the damage done to the roads can no longer be maintained, particularly as it is the highest rated cars that are taken out, on the average, least frequently, and do least harm to the surface If the real reason for the motor vehicle duty is sought, it is probably to be found in the belief that the possession of a car is a good indication of a person's ability to bear taxation Though this submission is not free from criticism—for instance, in respect of low priced vehicles used for business purposes—it is, on the whole, sounder than the theory which would connect payment with benefit But if one accepts the motor duty as a form of luxury tax, then the case for employing the revenue exclusively on the roads disappears Roads must, of course, continue to be built and maintained, but there seems to be no sufficient reason why the rate

of construction should be directly governed by the proceeds from a particular source of taxation

We have commented at this length on the motor vehicle duty and the Road Fund because they represent the most recent attempt on any scale to put the benefit theory of taxation into practice Yet even here, where conditions seemed most favourable, the rigid application of the principle was found impracticable In most other departments of national taxation the element of *quid pro quo* has disappeared altogether

§ 4 Where, however, as in local government, the area of administration is small and the ratepayers are closely gathered together, it is inevitable that the benefit factor should be more noticeable It is a much easier matter for persons in their capacity as citizens of a town to associate their local rates with the provision of a public recreation ground or a municipal hall than to link up the income tax which they pay to the State with the service of the defence or consular service The fact that the activities of the local authority are more readily kept in view by the ratepayers, and that a more immediate and direct control is exercised, appears to strengthen the impression that the rates are more or less commensurate with the benefits that the citizens receive

But this view is superficial To attempt to identify individual payments with individual benefits is usually an impossible task The district as a whole may gain considerably and even exclusively from the expenditure of the local revenue, but that is not to say that particular ratepayers enjoy the benefit in proportion to their specific contributions

The well to do people of a town make little use of the playing fields, in the cost and maintenance of which they share They send their children to private schools, though they are not on that account exempted from paying the education rate They contribute to the funds for the relief of the poor, though they do not, of course, derive any direct return Thus, the localisation of the benefit does not necessarily carry with it an apportionment on an individual basis The more in fact one considers the position the less one finds it to differ from that of national finance

Two further considerations serve to weaken what little argument remains in the benefit theory of taxation as applied to local finance The first is that all the advantages of the local services are by no means restricted to the locality that collectively pays for them Local expenditure on sanitation and the maintenance of a high standard of public health is surely as much of national as of local benefit Those towns in particular which possess a floating population, or to which a large number of visitors are in the habit of coming, would be quite unable, even if they had the desire, to limit or ration their facilities according to the amount of the individual rate contributions It is for such reasons of course, that the State makes substantial grants in aid out of the national revenues

The second consideration is that the size of the local unit is ever growing, both in area and in population Impracticable as it is in a small town to link up specific rates and benefits, it becomes still more difficult as the boundaries are widened and

the scale of activities is increased. The finances of some of our populous counties and cities already exceed those of the smaller nations of the world, and it would be absurd to expect them, because they happen to be described as local, to conform to a different, and possibly inferior, set of principles.

The benefit theory of taxation may have had some place in the earliest days of public finance, but its application to-day is extremely limited. With the growth of the political unit it has become almost impossible to make contributions to the State correspond in any exact degree to the value of the specific service rendered, and even in local finance, as we have shown, the relation between individual payment and benefit is very ill-defined. Statesmen and economists still differ among themselves as to the real character and purpose of taxation, but they are generally agreed on the inadequacy of the benefit principle in the fiscal systems of to-day.

2. The "Socio-Political" Theories

§ 5. The supporters of the financial and of the benefit theories, it has been pointed out, are not imbued with any idea other than that of obtaining the necessary funds in the most expeditious and convenient manner. A tax is nothing more to them than a fiscal instrument to be used as sparingly as possible, or as a measure, if only in a rough way, of benefits received from the central or local authority. To employ it for purposes of political advancement, economic development, or social

reform would be altogether foreign to their notions of the true character and purpose of public finance

Yet from the earliest days of government we find legislators employing the tax as a means of achieving some secondary purpose as well as raising revenue Indeed, there have been many occasions on which the monetary return has been placed subordinate to the other end in view For instance, when an import tariff is levied upon certain commodities in order to foster the production of those goods at home, the degree of protection afforded by the measure varies inversely with the amount of the revenue A Chancellor with protectionist views does not, of course, scorn such amounts as may accrue from the tariff, but he cannot hope, if the industry is adequately safeguarded, to derive a large revenue as well

Or the legislators may attempt, by discrimination in the rates of taxation, to develop certain industries or colonial territories Differential tariffs are now imposed to some extent in favour of colonial imports in an endeavour to divert some of the home demand from foreign to imperial produce Also, when the petrol duty was imposed, exemption was given to benzole in the expectation of stimulating the benzole and coal industries at home In all such instances the State deliberately deprives itself of a definite amount of revenue in the hope that the attainment of the ulterior object will more than compensate for the immediate financial sacrifice

§ 6 Such purposes of taxation would be governed by the "socio political" theory, which has been

most fully developed by German writers. This theory regards a tax as the legitimate instrument of the statesman who desires to effect some reform, whether in political, economic, or social affairs. Hence, for example, if the State wished to take political advantage of a monopoly that it possessed over an article required by other nations, it might decide to impose an export duty for achieving that purpose. If Parliament wished to foster a vital or infant industry at home, a tax on competitive imports might, according to this theory, be justifiably employed. And if it were held that the income of the people should be more equally distributed, a progressive scale of taxation, designed to fall most heavily on the richer members of the community, might, in the absence of more satisfactory methods, be brought into force.

The socio-political doctrine is therefore very comprehensive. While it is in many ways opposed to the financial theory, it should not, however, be identified with the socialistic view. To the extent that its supporters believe in using the tax as a weapon for obtaining a greater share for the working classes, they are on common ground with the socialists. But this object is not necessarily part of their programme. In fact, there is no defined programme at all, in the ordinary sense of the term. Those who believe in the socio-political theory of taxation need not be committed to any particular object of reform, or be associated with any single party. They simply hold the view that a tax may properly be used as an agency for effecting such reforms as the government think fit. The aim may be socialistic or it may be

just the reverse Hence the theory finds adherents in all political parties

The very comprehensiveness of the socio political theory is itself a ground for criticism To the view that a tax should be used for no purpose other than revenue raising, the theory serves as a valuable corrective There are few people to day who, after a moment's deliberation, would support the purely fiscal view in its crudest form Apart from this service, however, the socio political theory might be regarded as being too indefinite, especially as some of the objects that come within this view of taxation might well be incompatible with each other What many are in search of is a statement, not merely of the general character of taxation, but also of the particular purposes to which the revenue should be applied At this point the supporters of this very inclusive doctrine break up into several groups

§ 7 Some would deliberately aim, by means of taxation, at securing a more economical arrangement of our productive resources They may adopt the course of differential taxation, hoping that the favour shown to certain industries will bring about the desired development Or they may employ the more direct policy of giving subsidies out of tax revenues to those industries it is thought necessary to stimulate Both of these methods have been adopted by modern governments, notwithstanding serious criticism from the partisans of *laissez faire*

Others would employ taxation as a method of regulating consumption Certain articles are de

cidedly noxious, especially if consumed in large amounts, and it may be thought that their purchase could advantageously be restricted by the addition of a heavy duty to the ordinary price Other articles are of the luxury type, and, though they may be innocuous in themselves, an undue share of the country's resources may be considered to go to their production, causing the supply of more neces sary goods to be curtailed A tax on luxury articles may be proposed, not only because the expenditure on such commodities provides a good index of ability to pay (some would support it on this ground alone), but also because it is deemed advisable to dis courage all wasteful expenditure, as judged from the point of view of the community

Just as it is possible to employ taxation as a means of stimulating the production of necessary goods, so the proposal has been made, and in some cases carried into effect, to encourage the consumption of certain articles by selling them under cost and making good the loss out of public revenue This may be done either by handing over to the producers a sufficient sum to compensate them for the smaller price or by supplying the commodity, through State or local agency, direct to the public For instance, a municipality may desire, in the interests of public health, to increase the consumption of milk in the poorer neighbourhoods of the town By arrange ment with the retailers or, if this is not practicable, by direct supply, the children of the poor may be provided with milk at charges something less than the market price It is anticipated by the supporters of such schemes that the immediate loss will eventu-

ally be more than balanced by an improved physical stock and greater economic efficiency

§ 8 From the standpoint that a tax may be used for promoting the welfare of the people there is but a short step to the view that it may also be employed for rectifying some of the evils consequent upon the prevailing economic system Accordingly there has been developed what is known as the compensatory theory of taxation The political and legal organisation of the State may to some extent be responsible for large accumulations of wealth in some directions and comparative poverty in others This is not to say that the governments have directly or deliberately made it possible for certain classes to increase their possessions at the expense of the remainder of the people The inequalities may have arisen independently of the governing powers and even in the face of intervention The supporters of the compensatory theory maintain that although the central authority may have proved incapable of striking at the source of these inequalities there is no reason why it should not minimise the consequent evils by an appropriate scheme of taxation

Thus for example a monopolistic firm may make unduly large profits from the wants of the people But for the protection it receives from the State it might not be nearly so prosperous Perhaps it has been granted special legal powers in which event the partial responsibility of the State is even greater The advocates of the compensatory theory would urge the imposition of a special tax on monopoly profits so as to return some of the gains to the consumers Or a person may possess property which

increases in value, not because of any effort on his part, but because of the growth of population around the land or building, or possibly because of specific improvements in the vicinity undertaken by the public authority In such circumstances, it is maintained, a special tax on the "unearned increment" would be justifiable

The compensatory theory, it will be observed, is not necessarily socialistic There are many who would support a steeply graduated scale of income tax, or a land values or a "betterment" tax, who on other questions are totally opposed to the socialist programme It is one thing, they say, to repair such inequalities as those just mentioned, but quite another to embark upon a drastic scheme of redistribution Their position, however, is not well defined Although, on the larger socialistic issues, there may be a wide divergence of opinion between the two schools, the dividing line on the subject of taxation and welfare does not appear to be very sharply drawn

§ 9 We pass then, finally, to the socialistic theory of taxation, which maintains simply that the system of public finance should be so arranged as to reduce the inequalities of income of the various classes It favours heavy taxation of the rich and light imposts, if any at all, on the poor, so that the final distribution of incomes shall be less unequal than it is at present

To further his case the socialist often invokes the aid of the economic doctrine of diminishing utility, according to which the utility of successive units of a commodity owned by an individual diminishes

with every unit that is added to the stock. For ordinary purposes money may be regarded as a commodity. The richer a man is, the greater is the number of commodities he can purchase, but the smaller is the relative utility obtained from each additional unit of expenditure. The application by the socialist of this doctrine needs little demonstration. Transfer wealth by means of taxation, it is argued, from the rich to the poor. The utilities surrendered by the former will be less, pound for pound, than those acquired by the latter. The bounty to the poorer classes need not, of course, be given in cash. Wise expenditure on public services will, it is maintained, "socialise consumption", and add thereby to the total utility enjoyed.

It should be borne in mind that to socialists, as a class, progressive taxation, however steeply graduated, is but a second-best method. Until they attain the political power that will enable them to control the means of production, they are prepared to make what use they can of the tax weapon. But they are constantly affirming that, until the sources from which all incomes spring are in the hands of the State, the improvement must be very limited. The ardent socialist concentrates upon the control of production, which will permit him to appropriate, *before* distribution among the people takes place, such funds as are required by the public authorities. Under such extreme conditions the method of taxation would be altogether transmuted.

When we speak, however, of the socialistic theory of taxation, we do not refer to anything so advanced as this. We refer simply to the view that taxation

should be employed for smoothing out the existing inequalities in wealth and income. It is described as socialistic largely for want of a better name. If it were differently known, it would possibly command a wider acceptance. But, whatever name we care to give it, the fact remains that our fiscal system is already largely fashioned by this policy. The income tax and surtax between them are so graduated as to reduce the large incomes by a half. The death duties are very considerably cutting down the capital accumulations from which many such incomes are drawn. On the other hand, public expenditure on the social services is gradually increasing, thus adding, on balance, to the income of the working classes. It is not suggested, of course, that the desire for social amelioration has been the chief reason for the heavy taxation of the well-to-do. The exigencies of the war speeded up the rate of taxation far more than the movement for reform could possibly have done. Nevertheless, the amount compulsorily taken from the wealthy classes for the benefit of the less prosperous is greater now than it has ever been. Though, with the passing of time, the volume of taxation will probably be reduced, the proportion of the total revenue devoted to social purposes is almost certain to remain high.

CHAPTER II

THE NATURE OF PUBLIC EXPENDITURE

1 Private and Public Functions

§ 1 Though we are primarily concerned in this work with the economics of taxation it is natural and desirable that reference should constantly be made both to the extent and to the nature of public expenditure Obviously the question of the economic effects of abstracting large amounts from the tax payers turns largely on what the central and local authorities do with the money so derived It may be helpful therefore before we proceed to examine the incidence and effects of taxation to survey the main characteristics of public expenditure and the principal forms that it takes

There is a common tendency to bring to the study of public expenditure the same attitude of mind as one gives to private finance Representatives on national and local bodies are expected to deal with the demands of the spending departments in much the same way as if the requests came from branches of their own businesses It is a mistake however to assume an exact parallelism between public and private finance There are entries in private

accounts that have no counterpart in public budgets, while there are items in the latter that cannot possibly have a place in the former. Quite apart from the differences in the specific heads of expenditure, there are almost fundamental distinctions in their respective nature and purpose.

§ 2. One obvious distinction between private and public expenditure is to be found in the different relationship to income. The amount that an ordinary person or company can spend is strictly limited by the extent of the income available. For a time the orders for goods may proceed at a faster pace than the money wherewith to pay for them; but, needless to say, such a course cannot be long-lived. Governments and local authorities, however, do not experience this rigid limitation. They decide first what they wish to spend, and then proceed to set their fiscal machinery in motion in order to obtain the desired amounts. No wise administrator, of course, would devise a scheme of expenditure without bearing in mind the capacity of the taxpayers, and to that extent it is not strictly true to say that, differently from conditions of private finance, the expenditure determines the revenue, and not *vice versa*. But, as we shall show in the next chapter, the taxable capacity of the nation is a variable and indeterminate amount, and the limits to public expenditure are not immediately evident.

§ 3. Public expenditure also differs in some measure from private expenditure in the motive force behind it. Apart from purely personal expenditure, the ordinary individual seeks, where possible, to secure a surplus of revenue over expendi-

ture The degree of the anticipated balance often determines whether a particular outlay shall be made Public departments, on the contrary, are not inspired by this motive, except of course where, as in the case of the post office or local tramway services, they are intended from the start to be financially self supporting, and possibly profit-making as well In general, however, public ex penditure can be distinguished on these grounds from private expenditure, with corresponding differ ences in *outlook and method*

§ 4 Another difference, but also in degree rather than in essential principle, springs from the liability of public bodies to be influenced in their manner of spending by powerful sectional interests On the one hand it may be the defence departments pressing for expenditure on armaments and forces in excess of the proposed allowance On the other hand it may be one of the younger "social" departments enthusiastically pushing forward a scheme for en hancing the welfare of the working classes Private bodies are, in the main, exempt from this conflict of interests, although, when the business undertaking grows to larger proportions, amalgamates perhaps with other concerns, and covers a wide range of activities, a similar danger is liable to arise

§ 5 The distinction between the two kinds of spending really resolves itself into a difference in function Apart from those profit making public departments, which are more or less analogous to private businesses, it is undesirable to draw too close a comparison between private and public accounts The individual trader or company regards

net surplus as the crucial test. In the existing world of business he is not required to evaluate the usefulness of his enterprise in terms any other than those of cash. But the ordinary profit index, however usefully it may serve in private and competitive enterprise, is very inadequate when applied to the activities of most public departments. If a private concern that is engaged in supplying a necessary article fails to make a profit, it has sooner or later to close down, with possibly harmful consequences to the people as a whole as well as to itself. A public department is under no such obligation, although the absence of a profit incentive should not, of course, be a reason for slackness or inefficiency. There are certain articles, widely needed by the people at large, the consumption of which should not be allowed to fluctuate according to variations in price, and hence it may be expedient for the public body to maintain a constancy of the price that is not apparently justified by the cost of production. It may be permissible for the State or local department to sell the article at less than cost, if any serious abstention on the part of the consumer, following a so-called "economic price", would limit the expenditure on the necessary commodities, and possibly entail a general loss in efficiency and welfare. Water supply is a case in point. The money that was supposed to be lost through selling water at less than cost might well be regarded as an investment, the ultimate return to which would in all probability generously make up for the temporary loss.

§ 6. The "investment" character of some public

expenditure brings us to another point which distinguishes private from public finance. There are some forms of outlay, everywhere admitted to be essential from the standpoint of the community as a whole, which one cannot expect private persons to undertake, because such a considerable time has to elapse before any return, even where it can be reduced to monetary terms, can be expected. Consider, for example, afforestation. The number of landowners who are prepared to sink large capital sums and forgo a revenue in their lifetime for the benefit of their descendants is getting smaller. As a general rule an individual requires an income from his investment in a fairly short period of time. Those investments which cannot, by their nature, be expected to yield a revenue for several years, perhaps a generation or more, are frequently not undertaken at all, unless a public department assumes the responsibility. Though business concerns decay and disappear, the State must go on, and those at the helm of public affairs must necessarily look beyond their own lifetime.

§ 7. The differences between private and public functions, however, are not always well defined, and often there is much overlapping. There are, for instance, some private businesses, such as the Bank of England, which engage in activities of a semi-public kind. The profit motive may be important, but it is not paramount. Certain economists would like to see a steady increase in the number of these enterprises, which they prefer to publicly owned and operated departments. Other concerns, of the "public utility" type, are privately owned and

managed, but are subject, in the interests of the consumer, to a degree of national supervision and regulation. The functions of such undertakings and the activities of some State and municipal departments have much in common, despite the outward differences in ownership and direction.

2. The Classification of Public Expenditure

§ 8. It is just as difficult to draw up a rigid classification of the different types of public expenditure as it was, in the wider field, to make a clear-cut division between private and public functions. Many such attempts have been made, but they are either so general, or are hedged in with so many qualifications, that their practical value is not very great. John Stuart Mill divided public expenditure according to whether it was "necessary" or "optional", but the limitations of such a vague classification were soon evident. J. S. Nicholson[1] drew up more numerous categories, making revenue the determining condition. "*First*, expenditure without any direct return by way of revenue, *e.g.* poor relief, or in extreme cases even with indirect loss, *e.g.* expenditure on war. *Second*, expenditure without direct return, but with indirect benefit to the revenue, *e.g.* for education, it being supposed that eventually the educated are better taxpayers or cause less expense as paupers or criminals. *Third*, expenditure with partial direct return, *e.g.* education for which fees are received, subsidised railways that pay part of their expense. *Fourth*, expenditure that obtains a

[1] *Principles of Political Economy*, bk. v. ch. xv. sec. 3.

full return or in extreme cases yields a profit in addition, *e.g.* the post office, gas works, and generally State industries."

Still another classification is that favoured by Professor C. C. Plehn,[1] who arranges the expenditure under the heads of benefit rather than of revenue. He considers to be most important that expenditure which confers a common benefit on all, *e.g.* defence, consular service, roads, education; second, that which confers a special benefit on certain classes of the people, but which, owing to the capacity of these classes, should be regarded as a common benefit, *e.g.* poor relief and pensions; third, that which confers a special benefit on certain people and a common benefit on the nation in general, *e.g.* administration of justice; fourth, that which confers a special benefit on individuals, *e.g.* publicly owned industries.

§ 9. A common division, but one that is not free from ambiguity, is that drawn between "productive" and "unproductive" expenditure. A service may be viewed as "productive" in more than one sense. Some would take profit as the criterion. If money spent on the tramways, for example, yields a net surplus to the community, the venture has been "productive", but if the service is run at a loss, it is "unproductive". Such an argument has obvious limitations. Most public departments are of such a kind that their value to the community is not to be judged by the amount of profit that they make. Possibly the benefit to the public and the profit on the undertaking vary in inverse ratio.

[1] *Introduction to Public Finance*, pt. i. ch. i. sec. 6.

The advantage of a good water supply, to repeat, cannot be measured by the surplus made by the department concerned. The expenditure may be distinctly productive, even though the public authority appears to incur a financial loss. If it is undesirable to gauge the productiveness on a profit basis in the case of services for which a price is charged, what is to serve as criterion in the case of "free" services, such as roads, lighting, sanitation, and so on? Evidently productiveness, if it is to be a test of expenditure, must rest on a wider basis.

All these classifications, indeed, while useful in their way, suffer from the fault that besets any attempt to place public expenditure in rigidly defined categories. There is inevitable overlapping and duplication, whether classified according to revenue, benefit, or product, while several important forms of expenditure cannot satisfactorily be assigned to any one of the divisions. Even the expenditure, for example, on protecting the citizens against foreign aggressors and against wrongdoers at home might be regarded as a form of insurance premium, and thus be said to have a quasi-economic justification.

§ 10. Expenditure on defence is still considerable, and if we add the cost of the debt, which is almost entirely due to wars in the past, the burden is enormous. Before the Great War the ratio of the cost of the defence of this country to the total government expenditure (about £200,000,000) was 44·7 per cent; that of the debt services was 14·1 per cent. The total expenditure of the government in pre-war years was roughly 10 per cent of the aggregate national income. The cost of defence and debt,

therefore, before the war was just over 5 per cent of the total income of the country.

In the year following the war the respective ratios of expenditure on defence and debt were 16·8 and 42·4 per cent. The total percentages spent on these items in the two periods were thus approximately the same (about 60 per cent), but it must be remembered that the amount of the Budget, in terms of money, had quadrupled during the intervening years. The post-war Budget of £800,000,000 bore a ratio of 20 per cent to the aggregate national income. The cost of defence and the debt services therefore represented over 10 per cent of the total income of the people in the years following the war, compared with a little over 5 per cent a few years before. Also, in the post-war years there was a large additional cost in respect of war pensions.

The records of the pre-war and post-war expenditure of foreign countries under these heads are no less instructive. In France the ratio of the cost of defence to the total government expenditure fell from 40·3 per cent to 11·8 per cent (the increase in the proportion of the total expenditure to the national income should again be borne in mind), but the ratio of the debt services increased only from 21·5 to 22 per cent. In Italy the ratio of the cost of defence fell but little from 25·6 to 23·8, while her ratio of debt charges fell from 26·4 to 19 per cent. Japan's ratio of defence expenditure actually increased from 35·4 to 47·9, while her debt ratio fell from 26·3 to 10 per cent.

§ 11. The published returns of these countries yield an interesting comparison of expenditure under

other heads. The cost of collecting the revenue in the United Kingdom fell from 2·6 to 0·8 per cent, *i.e.* while the revenue quadrupled, the actual cost of obtaining it increased but slightly. The low ratio is due largely to the preponderance in the national revenues of direct taxation, which is notably economical to collect. In Italy the ratio of the cost of collecting the revenue was as high before the war as 11·5 per cent, falling in the post-war years to 7·5 per cent. In Japan the ratio fell from 1·7 to 1·2 per cent. The French returns are not given separately, being included under the head of civil administration. The cost of civil administration in the United Kingdom was 18·8 per cent before the war and 6·6 per cent in the years following it. In France the respective ratios were 21·6 and 6·6; in Italy 19·2 and 16·9; and in Japan 28·8 and 34·6 per cent. Though the methods of computation are not the same in the several countries, and the above percentages therefore must not be interpreted and related too closely, the ratios are sufficiently correct to allow of a general comparison.[1]

3. The Cost of National Debt

§ 12. All public debts do not necessarily constitute a real burden, nor must their respective nominal amounts be taken to indicate their relative degrees of severity. In particular it would be incorrect to compare the burdens of local and national

[1] For detailed comparative statistics of public expenditure in the above and other countries see G. F. Shirras, *The Science of Public Finance.*

indebtedness merely by reference to the published returns. Local debts are commonly incurred for the provision of some economic undertaking, the annual revenue from which, if it were specifically assessed, would cover the necessary charges, while the value of the enterprise would, as a general rule, be sufficient to meet the principal amount owing. The reason, of course, lies in the fact that local authorities in general are not prompted to borrow money, and are not in fact allowed to do so, unless there is a strong economic justification. The debt incurred by such authorities is comparable to that of a business undertaking, the assets of which are considerably in excess of its liabilities. The existence of a number of people who hold annual claims on a local authority or on a company is not incompatible with a sound financial position of the undertaking itself. National debts, on the contrary, are seldom of this kind. To the extent that a government borrows money for acquiring and developing the railway system or for embarking upon schemes of production, the debt incurred may be likened to that of an ordinary economic venture. But in the great majority of cases national debts have been created by wars, which are not regarded to-day, even by the most sanguine apologists, as economically productive. The capital borrowed during the years of war is literally blown away. Though the exigencies of the time may render it imperative that this wasteful expenditure should be incurred, the interest that has to be paid in the succeeding generations cannot, by any stretch of the imagination, be considered as coming from the capital borrowed and used up

during the years of war. It is because the interest, and also the principal, have to be paid out of current income that a national debt can be said to constitute a real burden.

§ 13. Several factors have to be borne in mind in estimating the net burden of a public debt. The first consideration is the extent to which the capital and interest payments are kept within the national boundaries. Where a large proportion of the stock is held by foreigners the burden of the debt is heavy, for each year the people of the debtor nation have to part with a proportion of their total product. The payments that are thus made may be likened to an annual tribute levied by the creditor upon the debtor nation. But where the whole, or the greater part, of the capital sum is owing to the nationals themselves, entailing periodical internal payments, the real burden upon the community as a whole is not so serious. The burden of the British National Debt would be appreciably greater if we owed the greater part of it to other countries instead of nine-tenths to ourselves.

§ 14. In the classification of public expenditure in the previous section, a distinction might have been drawn between "exhaustive" and "transfer" expenditure. Under the former head is denoted the physical consumption of economic resources by the public authority. The construction of a gun or a battleship, of a building or furniture for its equipment, of roads or bridges, would come within this category. Under the latter head is comprised such outlay as does not involve the public departments in direct consumption, but entails

rather a transfer of purchasing power from the tax-payer to the recipient of the public payments The National Debt services, apart from the actual cost of administration (which is of an "exhaustive" character), fall in the second category If, to the expenditure on the National Debt, which constitutes nearly a half of the Budget, there is added the cost of pensions and similar items, the proportion of payments that represent internal transferences is found to be very high The real burden of this part of the national expenditure depends then, first, on the economic reactions to which the necessary taxation gives rise, and, secondly, on the use which the recipients and beneficiaries make of the sums transferred Both these questions have still to be more fully discussed It should be evident, however, even at this stage, that expenditure which is of the "transfer" type tends to be less burdensome on a community as a whole than expenditure of the "exhaustive" kind [1]

§ 15 The burden of the National Debt services is influenced too by the manner of distribution both of the national wealth and the national income If this wealth and income were fairly evenly divided, and if, furthermore, the debt were held by every body in more equal amounts, the real burden would be considerably smaller than it is now Actually, however, the capital of the country is distributed in an extremely unequal fashion, while the division of the income is not very much better As a result of this unequal distribution, the possession of

[1] For a detailed analysis of transfer and exhaustive ' expenditure see Pigou *A Study in Public Finance* pt i ch iii

government stocks is largely confined to a small section of the people. (Although there are millions of people altogether holding government stocks in one form or another, the bulk of the value of such holdings is in the hands of a small minority.) On the other hand, the taxes that are levied wherewith to pay the dividends to those people are steeply graduated, with the result that the rich investors who receive considerable interest payments from the State are also required to pay heavy taxes. If it were true that the taxes on the rich were relatively as heavy as the dividends they drew on government stocks, and if it were true, further, that the absence of such capital possessions on the part of the poorer classes meant a corresponding relief from taxation, then the distributional aspect of this problem would not be serious. But there is ample evidence to show that the real burden of the National Debt tends to fall with greater severity on the poorer classes, and that the more prosperous government stockholders, though admittedly they are heavily taxed already, are in a strong enough position to bear some differentiation of the charge.

§ 16. The National Debt is also said to discriminate in the severity of its burden, not only between the rich and the poor, but also, to some extent, between the old and the young. Nearly the whole of the present Debt was incurred between 1914 and 1918, and the present holders are, for the most part, getting on in years. Such a position is open to criticism on more than one ground. First, there is the submission that, while the young offered and often gave their lives during the years of war, their

elders *lent* their wealth and are now exacting an annual toll. In the second place, it is maintained that the transference of wealth and income from the comparatively young to the comparatively old militates against enterprise and efficiency. While there is some force in these contentions, its application is limited and temporary. The above fears rest on the assumption that the owner of capital uses it and initiates ventures himself, whereas, very often, he leaves its direction and control in the hands of other, and possibly younger, men. Also, with the passing of the generations, the significance of the present differentiation in favour of the old will disappear, and those who are now young will in turn become the possessors of the estates.

Though the importance of the discrimination against the young in favour of the old is apt to be exaggerated, there is some truth in the wider criticism that the payment of three hundred millions a year in dividends on government stocks is unduly favourable to the *rentier* class, irrespective of age, at the expense of the more active and venturesome sections of the public. If, in order to meet the annual obligations to the stockholders, the comparatively progressive classes are severely taxed and their business enterprise is checked, the national income and welfare is bound to suffer. If the prospect of a secure and regular income induces the stockholder to relax his personal efforts and to become dependent on the passive earnings of his public stocks, the economic position of the nation is still further damaged.

§ 17. We have shown that the burden of the

National Debt differentiates among the rich and the poor, among the old and the young, and among the *rentier* and venturesome classes, at a particular time. It can also be shown that the burden usually falls with greater severity as one proceeds from one period to another. National debts are, to repeat, almost invariably created in times of war, and it is at such times that prices are distinctly higher than the average. In the years following a war, prices almost inevitably decline, but, unless the government has made some special provision for reducing the money interest on long-dated loans, the real income derived by the stockholder increases every time there is a drop in prices. In other words, the real charge upon the community, measured in goods and services, goes up as the general level of prices goes down. For example, when an investor lent £100 to the State during the war, he was content to receive annually the sum of £5, or, say, the equivalent then of a suit of clothes. He still receives his £5, but, with the appreciable drop in prices during the past decade, he buys with the money not only a suit of clothes, but an overcoat as well. The extra overcoat represents, so to speak, the additional burden on the people that is attributable to the existing system of administering the National Debt. Theoretically the stockholder is liable to suffer a reduction in his real income in the event of prices rising and remaining above the war level, but experience proves that such an event is extremely unlikely.

§ 18. The problem, while easy to state in this way, is more difficult to deal with in practice. Looking back, one might argue that, just as the State made

provision for workers in its employ to receive lower money wages each time there was a drop in the cost of living, and provided facilities for the adoption of this principle in private employment, so it might have arranged for interest on the Debt, and the principal itself, to be calculated on a sliding scale. It would have been quite equitable if the government had pursued such a course from the start, though it is uncertain whether as much money would have been raised on this basis as was actually obtained. But the time was allowed to pass without seizing the opportunity, and it is doubtful whether this is a proper occasion to remedy the situation. If the government were suddenly to announce its intention of reducing the rate of interest to a figure equivalent to the original purchasing power, it would, without question, be accused of a breach of faith, and a decline in its credit would be liable to follow. The contention that the government was only reverting to the dividend in terms of goods and services, with which the lender expressed satisfaction at the time that the money was lent, would be perfectly sound so far as it went, but would be countered by the retort that the government made a promise to pay so much *money*, and that it was on that understanding that capital was subscribed and that subsequent dealings and contracts were undertaken. Further, there is a practical difficulty arising from the change of ownership that has to a large extent been effected since the stock was first issued. Sales have taken place daily for over ten years, and the market prices of the securities have naturally been influenced by considerations of purchasing power. If the government were

to declare its intention of reducing the percentage of interest, it would, on the one hand, severely embarrass those who had bought the securities during the last few years, though it would, on the other hand, recover some of the increment from the original investors who were still in possession of the stocks.

4. The Cost of the Social Services

§ 19. An increase in the expenditure on social services might be taken to signify either of two things. It might, on the one hand, be interpreted as a sign of a country's prosperity and of its ability to provide for the needs of the poorer classes from the ample funds of the nation as a whole. It might, on the contrary, be construed as denoting a growth in the poverty of a large proportion of the nation, to alleviate which the more fortunate sections were more heavily taxed, even though their actual wealth and income were on the down-grade. Obviously the true significance of such expenditure cannot be estimated merely by reference to the figures themselves, but have to be considered in relation to all the economic and social circumstances of the nation at a particular time. Thus, the rise in public expenditure on the social services in the latter part of the nineteenth and the early years of the twentieth century was perfectly consistent with, and was to some extent the result of, the material progress of the nation. During the last few years, however, the expenditure on these objects has, taken as a whole, enormously advanced, yet nobody but the

profoundest optimist would interpret the increase as commensurate with the growth of the wealth-producing powers of the nation in general. In so far as the figures have been swelled by the subventions to the unemployment insurance scheme, the explanation has to be found in depression rather than in prosperity.

§ 20. A necessary preliminary step in analysing the official statements of the public social services,[1] and comparing the expenditure with that on other objects, is to separate those figures that represent the charges falling directly on the central and local authorities, *i.e.* on the taxpayers as such, and those that represent "other receipts", such as, for example, the contributions of employers and employed to the various insurance funds, and the revenue from endowments and voluntary contributions to the education services. The total expenditure in Great Britain in 1929 on the public social services was stated to be about £395 millions.[2] Of this total, £128 millions came from individual contributions and payments, £91 millions from local rates, and £176 millions from national taxes. The official return, however, includes the cost of war pensions, which, in 1929, amounted to £54 millions. If this figure were deducted, as it ought to be, from the gross amounts, the payments from the State would be reduced to £122 millions, or the aggregate expenditure to £341 millions.

[1] See Appendix, Tables V and VI, for details of expenditure on the social services.

[2] Parliamentary Return, December 15, 1930. The estimated figures were £348,930,000 for England and Wales, and £46,853,000 for Scotland, a total of £395,783,000.

Furthermore, if it is intended to show how much of the above amount represents a net transference to the working classes, who are the chief beneficiaries of the social services, it is necessary to deduct the amounts that they pay in contributions to certain of the services, as well, of course, as the sums that they pay in taxes. Roughly one-third of the social insurance expenditure is ordinarily met by workpeople's contributions. The ultimate destination of the money laid out by employers under this head cannot be traced with any precision, but such expenditure is usually included in production costs, and passed on to the consumers. Though it is impossible to calculate the extent to which this cost is borne by the different sections of the community, there is no question that much of it is shifted to the wage-earning classes.

On the other hand, there are items of social expenditure that are not recorded in the above official returns. There is, for example, the considerable annual outlay by employers on workmen's compensation and similar obligations. Notably, too, there is the cost in recent years of assisting the unemployment insurance funds out of loans. Unless the amounts borrowed are fully repaid—an unlikely contingency—such expenditure ought to be taken into account in computing the total cost of this service and in apportioning the benefit. Also, there have been several constructional and other public undertakings which have been designed, not only for their direct value, but for the relief that they were expected to give to the labour market. This is not, of course, a criticism of such measures, for even if the schemes

were not in all cases justifiable from the strictly financial point of view, the nominal loss might be far less than the saving in out-of-work benefit, not to mention the advantages of maintaining the morale of the workers. The degree in which such outlay partakes of the nature of "social" expenditure cannot be exactly estimated, but its presence should not on that account be overlooked.

§ 21. These considerations demonstrate the difficulty of exactly computing the extent of the social services and the manner of their apportionment. Taking the figures as a whole, however, there is no doubt that the social services have materially assisted in the redistribution of income that has been taking place during the last fifty years. The present expenditure on these services, including local outgoings, and also taking insurance contributions and similar non-tax payments into account, represents a gross addition of about three shillings in the pound to the wage-earner's income.[1] It was stated in the Colwyn Report that the revenue obtained in 1925–26 from the average family of this class amounted to about two shillings in the pound;[2] with the subsequent remission of the tea duty, the proportion is probably now rather less. Their other net payments, though

[1] See H. Clay, *The Authoritarian Element in Distribution*, Economic Journal, March 1927 (reprinted in the author's *The Problem of Industrial Relations*, 1929), where it is estimated that the ratio of expenditure on social services to wages in 1880 was 3·4 per cent; in 1911, 9·4 per cent; in 1913, 10·4 per cent; and in 1924, "not less than one to eight". In view of the considerable increase in social expenditure since 1924, the above-mentioned figure of 3s. in the £ may be regarded as a conservative estimate.

[2] See Appendix, Tables VII and VIII.

not calculable with any precision, are probably insufficient to cancel the balance in their favour. Members of all parties have for long been agreed that some measure of redistribution was necessary, but now that the differences in incomes have been to some extent reduced as a result of public expenditure, there are many who, while formerly approving of the general desirability of this reform, are now apprehensive that it has gone too far, or, at any rate, that it is proceeding too quickly in relation to the economic conditions of to-day.

§ 22. Discussion on the social services is rendered difficult by the fact that the motives underlying the expenditure are not always the same, and are, in fact, sometimes opposed. The most general argument at the present time comes, of course, from socialist quarters, but it would be untrue to assume that the opponents of socialism are averse from such expenditure, or, for that matter, that all socialists are necessarily in favour of it. There are many of the latter who frankly suspect the efficacy of spending public money on these services, particularly if such expenditure is regarded by those in authority as a complete substitute for more fundamental policy and action. While they are anxious to retain and even expand these services for immediate alleviation of poverty, they constantly aver that nothing short of a complete socialisation of the economic system will effect a genuine and permanent cure.[1] Their political opponents may, on certain forms of social expenditure, be hardly less keen, though their motives may be of a different order. They, too, may be inspired

[1] See above, p. 22.

by ideas of social reform, but not to the extent and in the manner advocated by the socialists Many, again, not confined to any one political party, are opportunists simply, who see the unwisdom, from a partisan standpoint, of cutting down the social services, thereby alienating, perhaps, the sympathies of a large body of the electorate

The case for the social services, however, would be very incomplete if it rested only on political and humanitarian grounds The main justification of these services, from the point of view of the economist, depends on the extent to which they add to, or at least sustain, the efficiency of the recipient They may do so directly, as by wise expenditure on education and the public health, in increasing the mental and bodily equipment of the people They may do so indirectly, as by insurance, in preventing deterioration and decay One need not go to the length of asserting, as some still do, that the expenditure on the maintenance of the unemployed during the last few years should be likened to an insurance premium against the risk of revolution, though there may be more than a grain of truth in this submission The position can be defended more simply and less controversially It is a well known fact, borne out by evidence in all parts of the country, that the physical standards of the people have not been lowered during the last decade to anything near the extent as used to be experienced, comparatively speaking, in the days when unemployment signified almost immediate distress The fact that the unemployed and their children are not as physically impaired as they would have been in the

absence of these nominally costly claims of public assistance must mean a higher potential economic capacity than one which would otherwise exist Its value cannot be exactly calculated, but the importance of maintaining our productive resources at a high level should need little argument [1]

§ 23 Some, though by no means all, economists would justify social expenditure, up to a point, on the ground that it permits of an addition to the wage-earner's real income, without involving a flat-rate increase in money wages or in the costs of production It makes possible a closer approximation of wages to needs without throwing the charge indiscriminately on all employers, irrespective of their power to bear it The reasoning is simple, though not free from criticism. If, as a result of trade union pressure or State legislation, the minimum wage in a particular trade is raised, the additional cost has to

[1] Support for social expenditure on economic grounds is not confined to academic theorists The Balfour Committee, for example which included many eminent industrialists, asserted in 1929 that "from our point of view, the most important consideration is not the direct money cost of social services, but their effects on industrial efficiency At present Great Britain occupies a unique position in this matter *In no other great commercial country, so far as we are aware, is there anything approaching the same public expenditure on safeguarding the standard of life of the working population and protecting them from the consequences of the various risks of life and industry* The primary effect is to improve materially the well being of the industrial population in ways in which such improvement could not have been achieved by individual effort except at enormously greater cost The sense of security and the relief from suffering thus obtained is a national and personal asset of the highest value, which is often neglected in making comparisons of British wages and conditions of labour with those obtaining in other countries (Committee on Industry and Trade, Final Report 1929, pp 257 8)

be met, not only by the firms whose profits are more than enough to stand it, but by the "marginal" firms who are already just making ends meet If the higher wages can be said to induce a greater efficiency either of the workers or, through the stimulus to better management, of the employers, there is a strong case for this direct method But where the marginal concerns have no such outlet or opportunity, the increase in their costs may involve them in such difficulties that they have to curtail their production and even close down

Indirect additions to wages, by means of public social expenditure, the argument continues, do not have such a result Since it may be presumed that the greater part of the cost comes from those taxes that are progressively adjusted according to individual ability to pay, the method is claimed to work out more discriminately and equitably than that of direct wages advances, and less prejudicially to those firms that are not in a position to meet an increase in costs Under the prevailing system of income tax and surtax, from which a large proportion of the social service funds is expected to be drawn, the rate of such taxation may vary from nothing, in the case of the marginal firm, to a high proportion in the case of the wealthy employer In this way, so far as the cost of indirect additions to wages can be set against profits, the prosperous firms pay more than the equivalent of a flat rate wages advance, while the firms nearer the margin pay less

One criticism of this method is that it may impose in effect a penalty on the more efficient firms The supporters of the plan have therefore to maintain

and if possible to prove, that the tax is devised in such a way that it does not enter into costs, but falls on realised surpluses only This problem will be considered at some length in the chapters on the income tax[1] Another criticism of the indirect method of raising the wage-earner's real income is that he does not receive the same stimulus to effort as that afforded by the prospect of a direct wages advance The force of this criticism varies with the nature of the occupation, the quality of the organisation, the system of wages payment employed, and many other factors, both industrial and personal, an examination of which would take us beyond the bounds of the present work

§ 24 Broadly speaking, the economic effects on the beneficiary depend largely on the nature of the public service It needs no argument to show that, if the scheme is so badly devised that the recipient finds it to his advantage to limit his efforts and curtail his output, the results are almost bound to be harmful The moral damage is liable to be no less severe than the economic A source of criticism of the unemployment insurance scheme has been the alleged failure to deal adequately with those claimants (usually exaggerated in number) who prefer drawing benefit to finding work A frequent objection to the conditions formerly governing the non contributory old age pensions was that, by imposing a fairly stiff means test, they virtually placed a penalty on thrift The effects on the beneficiary depend also, to some extent, on the form which the service takes Commonly it involves the making of cash payments,

[1] See pp 138-147

and thus the character of the final expenditure, and the economic conditions to which it gives rise, are left largely in the hands of the individual recipients, who may, or may not, make the most advantageous use of the amounts received A large part of the public social services, however, entails but little addition to the money income of the beneficiary The costs, for example, of education, public health and housing grants, which between them amount to £140 millions, or nearly one half of the total net social expenditure (i e excluding war pensions), contain a negligible proportion of direct money payments The proportion becomes still greater as account is taken of institutional and other benefits in kind under the poor relief health insurance, and similar schemes

The problem turns also on the nature of the commodities and services comprising the subventions, and on the character of the individual beneficiary If the goods in question are of such a kind that the recipient can be relied upon to purchase them, either with his own means or with money received from the public body, this mode of assistance would seem to have little advantage over the other, except in so far as bulk purchases might prove more economical *The continuous receipt of such assistance in* kind might, under certain conditions, have the same prejudicial effects on the person's will to work as an ill advised and indiscriminate system of cash relief The situation is different, however, where the goods and services are of a kind which the recipient ought in the general interests to enjoy, but which, in the absence of a scheme of public supply, he could not be depended upon, or could not afford, to procure

Education, public libraries, open-air spaces, medical facilities, are but a few instances of this type of public service, the ultimate return to which is no less important than the immediate social advantage.

Against the benefits to the recipient have to be weighed the effects on the general body of taxpayers. The heavy expenditure on the social services, to the extent that it is met by compulsory exactions, might conceivably have a prejudicial influence on the enterprise and efficiency of the industrialist, but, as we no longer have a financial system in which the proceeds from certain taxes are specifically earmarked for certain services, it is impossible to estimate with any precision the taxpayer's particular reactions to the amounts appropriated for social expenditure. That there may be a psychological relation between this kind of expenditure and the taxpayer's outlook and enterprise is not denied, but the stage at which this influence can be measured, or even roughly estimated, has not yet been reached. It is more practicable to study the effects of the tax exactions as a whole, and of the chief forms of revenue in particular, and this in the subsequent chapters we shall proceed to do.

CHAPTER III

TAXABLE CAPACITY AND THE NATIONAL INCOME

§ 1 In these days of large budgets we frequently come across the contention that the burden of taxation is as heavy as the nation can possibly bear, if, indeed, the limit of safety has not already been passed. Gloomy comparisons are drawn between the ratios of taxation in this country and elsewhere, and we are told of the dire consequences that are bound to follow if the policy of over taxation is persisted in About one fifth of our national income is appropriated by the Exchequer for public purposes, not to mention the additional amounts taken by the local authorities Before the war the proportion was less than one tenth. In the United States at the present time only one half of our percentage burden is extracted from the pockets of the people for Federal and State objects Other countries, too, have a smaller ratio than ours From crude statements like these it is quite an easy matter to enlarge upon the heavy charge that falls upon the British taxpayer, and upon the disadvantages in competition with his lightly taxed foreign rivals

But, it should hardly be necessary to point out, the taxable capacity of a nation cannot be ascertained and compared in such a simple manner as this. It is not possible, although more than one statistician has essayed the task, to construct a mathematical formula, from which one can deduce that such-and-such a percentage represents a country's taxable capacity. The conception is purely relative, depending upon circumstances, economic and non-economic, that vary from nation to nation and from time to time.

Numerous definitions of taxable capacity have been attempted. One writer's description of it as "the limit of squeezability" is forcible and expressive, but it is very vague. Some nations will permit themselves to be squeezed much less than others, although, if occasion requires, their reluctance may give place to a marked expression of willingness. And inside a nation the limit of squeezability varies from one person to another. Even if one could work out arithmetically the taxable capacity of a person with a given income, the total capacity of a thousand such persons would not necessarily be a thousand times as great. One man may require a larger net income than another to induce him to carry on his economic activities. Or he may have outgoings, business and private, that do not apply to another man whose gross income is the same.

§ 2. The same kind of criticism applies, though not in the same degree, to the more usual definition of taxable capacity as the maximum amount that can be deducted from a country's income, consistent with the maintenance of that income in years to

come. To put this in another way, there is said to be a minimum sum which must be left with the people in order to ensure their continued ability and willingness to work. But the extent of this minimum, and the nature of the goods on which it is to be expended, is very indefinite. Does it mean the bare subsistence level, below which people cannot possibly live and produce? Or does it mean the standard of living to which the mass of the population have become habituated? If the former is implied, the taxable capacity of a progressive country such as Britain would work out at a considerably higher proportion than most of us would admit. Only in times of acute stress would one accept the minimum of consumption as synonymous with that of subsistence. If, on the other hand, it is taken to mean the customary standard of living, the definition becomes only slightly better, for the standard of living is a notoriously uncertain quantity. There is no fixity about it, fluctuating as it does from person to person, and from time to time. Thus it is not satisfactory merely to adopt such a method as taking the individual subsistence level or standard of living, multiplying it by the number of the people, deducting the total from the national income, and from the balance obtaining the supposed taxable capacity of the country.

Nor is it desirable in defining taxable capacity to lay down the condition that the income-producing powers of the country should be restricted to the existing level. The people of a progressive nation are accustomed to see their income per head, as well as in the aggregate, grow from year to year. The American people, for example, augmented their *per*

capita income by nearly 7 per cent every year during the ten years following the Great War, though this was an exceptional rate of increase as events have since proved. Any estimate of taxable capacity, unless it were being made for abnormal times when the life of the nation was at stake, would have to take into account the customary additions to wealth and income.

There is thus indicated a second limit to taxable capacity—that imposed by capital resources. It has sometimes been said that during the later years of the war the British Government spent up to 40 per cent of the total national income. But such statements can be very misleading, for we do not know to what extent the cost of the war was met out of the stocks of capital goods which the nation possessed. In so far as these stocks were exhausted, and insufficient provision was made for renewal and normal addition, it might be contended that the country during those years was living on its accumulated capital. Whether or not one makes allowance for capital growth in computations of taxable capacity is a matter of opinion. In ordinary times there seems to be no adequate reason why this allowance should not be made. A certain rate of increase in income and capital per head is regarded as normal, and a nation which does not go forward is liable, in relation to other nations, to go backward. But in times of war or other emergency there is some justification for excluding such considerations from the estimates of taxable capacity. Administrators on such occasions can be forgiven for heavily discounting the future in their efforts to safeguard the present.

§ 3. There are, then, two main limits to the taxable

capacity of the nation, one applicable to normal times, and the other, beyond the first, chiefly to be regarded in times of stress. But even the wider limit is liable to be transgressed, should circumstances become very pressing. Neither of the limits is clearly marked, and there is no definite warning note when it is being approached. From the restricted point of view of the Exchequer, a danger signal is observed when the continuance or increase of the scales of taxation results in a reduction of the revenue. But this is not necessarily a trustworthy index of the true position. It may be that the limit has been passed long before, but that it has taken some time for the reactions on national income to take place. It is not satisfactory, therefore, for a government to wait until the actual revenue begins to fall off. Serious damage may have already been caused. On the other hand, the contraction of the revenue may be altogether independent of the true taxable capacity, the limits of which have not yet been approached. It may depend on the character of the taxation and on the nature of the objects on which it is based. If, for example, the taxes are mainly indirect and are levied to a large extent on articles of luxury, a falling-off in the revenue may merely point to an elastic demand for those goods, without in any way giving an indication of the country's taxable limits. But if the bulk of the taxes falls directly upon the income of the people, a reduction in the revenue is a surer, but not an infallible, sign of a contraction in the volume of production. This may be due to an excessive rate of taxation, or it may arise from conditions of an entirely different kind.

§ 4. The nature and the methods of the taxation itself have a great deal to do with the determination of taxable capacity. An unscientific method of raising revenue may be less productive and arouse greater resentment than one which is judiciously planned and carried out. There can be little doubt that, had direct taxation not been introduced into our fiscal scheme, our taxable capacity would have been estimated at a much lower level than has actually been found practicable. Taxation of commodities, however wide the net, could not possibly have provided the large revenues that modern governments have required. Direct taxation permits of progressive scales altogether impossible in the older systems of indirect taxation. Quite apart from reasons of equity, which alone can be proved to justify direct taxation, the actual needs of the Exchequer necessitated the introduction of the new system. Other nations lagged behind Britain (though she was by no means the first) in introducing the income and similar taxes, but during the last few decades most of them have fallen into line.

Those taxes which arouse least resentment or interfere the least with economic enterprise permit of a higher taxable capacity than do taxes which are constantly causing friction and damage. If the government attempted to raise the sums which it now draws in death duties directly from people's estates during life, far more protest would be made than at present, more harm would be done to business enterprise, and probably much less revenue would be obtained.

§ 5. It is evident from what we have said that

taxable capacity must be treated as a dynamic, not as a static, problem. It is not enough to examine the immediate consequences of taxation upon the income of different people. More important, from the point of view of the statesman, is the probable reaction upon the economic incentive of the taxpayer and upon the wealth-producing powers of the nation in general. Viewed in this way, the task of computing the taxable capacity of the nation becomes more difficult than ever. The few estimates that have been made by responsible authorities are so hedged in with qualifications that a very wide margin has to be allowed in applying them.[1] Some of the determining factors are more or less known and measurable, and find their proper place in the calculations. But others, while they are recognised as having an important bearing upon the problem, cannot, with our present knowledge, be reduced to arithmetical terms.

§ 6. The size of the population, for instance, is definitely known, while the extent of the national income is sufficiently ascertainable for us to draw some broad conclusions. It is obvious that, if the population increases at a faster rate than the national income, the taxable capacity of the people is diminished; if, as is the rule in progressive countries, the national income grows more rapidly than the population, the taxable capacity is increased. Even though the estimate of what constitutes the minimum standard of living is apt to become more generous as the income of the people is increased, the surplus of income over this minimum tends to grow even more

[1] See *Wealth and Taxable Capacity*, by Sir J. C. Stamp.

quickly, and it is from the surplus that the taxable capacity is computed.

A merely arithmetical statement of the national income, however, does not tell us everything. Besides knowing the aggregate quantity of the volume of production, it is helpful to be informed of the general nature of the goods and services that constitute the country's real income. We have already implied that the greater is the proportion of the income that is devoted to consumption of an unessential kind, the greater tends to be the taxable capacity. Similarly, one country's income may in aggregate be the same as another's, but if the ratio devoted to necessary goods in the first country is greater or smaller than that in the second, the taxable capacity will be smaller or greater as the case may be. For instance, country A may have the same population and the same total income as country B. In A the necessaries of life are relatively more expensive than in B, leaving the citizens of the first country a smaller surplus to devote to articles of comfort and luxury. The latter commodities may be relatively cheaper in A, but the people are unable to buy sufficient of them to raise the real income to the level prevailing in B. Under such conditions the taxable capacity of A will be less than that of B.

§ 7. Until now we have been mainly concerned with the relationship between taxable capacity and the national income as a whole. Of no less importance is the manner in which the total income is distributed among the taxpayers. It can readily be shown that, within certain limits, the greater is the inequality in the apportionment of income, the

greater is the taxable capacity of the people concerned. For example, if one man has £2000 a year, and twenty men have £100 a year, the taxable capacity of the prosperous individual will, as a rule, be greater than the collective taxable capacity of the other score. If the £4000 were equally allocated among the twenty-one men, the aggregate taxable capacity would be reduced. This conclusion is in accordance with the principle of diminishing utility, to which reference has already been made, whereby a consumer derives a smaller and smaller utility from equal units of wealth successively added to his stock. A person gains less satisfaction from the second £100 than from the first. Our prosperous £2000 a year man does not obtain nearly twenty times as much utility as does the £100 a year man, or, to express it differently, his total utility is considerably less than the aggregate of the twenty men. The surplus enjoyed by the well-to-do person is greater than the aggregate surplus of the less fortunate citizens, and, therefore, his taxable capacity tends to be greater. Thus, countries A and B may be alike in all other respects, but if the income in A is more unequally distributed than it is in B, the taxable capacity of the former country will tend on this account to be the greater.

The fact that inequality makes for a greater taxable capacity does not, of course, vindicate in any way the uneven distribution that is ordinarily experienced. A high taxable capacity has no particular merit in itself. A government is not always under the obligation to raise the maximum amount of revenue. An important motive for taxation in

modern times springs from the desire to alleviate the hardship that is partly attributable to the existing system of distribution. If an improvement in distribution led to a reduction in the country's taxable capacity, there would be no cause for disquietude, for one of the chief reasons for high taxation would have disappeared.

That the income of this country is very unequally distributed needs little comment. Several investigations, some of them very thorough and carried out in a strictly impartial manner, have been undertaken during the last twenty years, and, although there have been certain differences in the findings, they all point to the concentration of a large portion of the aggregate income in the hands of a small proportion of the population. The best known and the most reliable inquiries are those of Professor Bowley and Sir Josiah Stamp, who have, separately and jointly, published several studies on the subject. The former has calculated[1] that before the war about 1 per cent of all income receivers appropriated about 30 per cent of the aggregate income of the country. Nearly a half of the income went to a little over 5 per cent of the income receivers.

In a more recent publication[2] these writers have shown that the share going to the wage-earning classes, which was about 43 per cent before the war, rose to about 44 per cent by 1924. They point out, however, that the actual proportion going to the working classes increased by rather more than this small difference. The progressive scales of taxation

[1] *The Change in the Distribution of the National Income*, 1920.
[2] *The National Income, 1924*, 1927.

caused a much greater percentage to be deducted from the incomes of the well-to-do than from the middle and lower ranges of income. These scales brought about, in effect, a certain redistribution of the net incomes going to the various classes, the rough extent of which was indicated in the previous chapter.

§ 8. In the long run the taxable capacity of a nation is largely governed, not only by the size of the national income and the way in which it is distributed, but also by the nature of the objects to which the tax revenue is devoted. For the time being the taxpayer is concerned with the simple fact that the State has compulsorily exacted from him a certain sum of money. But it may turn out eventually that the purposes to which the money has been directed do not materially, if at all, reduce the gross wealth and income of the country as a whole. Thus, of the £800 millions that the State annually raises in taxation, over £300 millions flows back into the pockets of the British taxpayers in the form of interest on debt and repayment of principal. There is no question that the taxable capacity of the country would be considerably less if these payments went abroad instead of remaining at home.[1] To the extent, then, that the public expenditure takes the form of internal transferences of income, without actually exhausting any of the country's resources, neither the national income nor the taxable capacity is directly diminished. Hence a crude comparison between the tax burdens of this and other countries is liable to yield false conclusions. The other countries may have a larger proportion of

[1] See above, p. 35.

their debt owing abroad, in which case the interest and principal charges reduce to a greater extent the national income and the taxable capacity. Or they may have a comparatively small debt, and, therefore, a lower scale of taxation, and yet, owing to the drain of payments abroad, feel the burden just as heavily as we in this country who owe most of the debt to ourselves.

Such considerations have even more force where the money derived from taxation is expended on reproductive objects. If taxes are levied for the purpose of improving the roads, or developing the telephone system, or extending any other of the economic activities that modern states are constantly undertaking, the real burden of taxation cannot be estimated until the returns from the capital outlay have been taken into account. What the country can "afford" is a relative matter, depending upon the object of the expenditure. It might not be able to afford a further ten millions for the army or the navy, yet be perfectly justified in spending twice that amount in some developmental work which would eventually add to the income and welfare of the nation.

§ 9. Finally, it need hardly be said that the taxable capacity of a country is influenced to a large extent by political and psychological considerations which do not lend themselves to measurement in economic terms. The taxable capacity of a nation at war is greater than that of the same nation at peace, partly because the government encroaches upon the amounts ordinarily devoted to capital renewals and extensions, and partly because the people are prepared to make greater sacrifices, and to cut

down the so-called minimum standard of life that they usually insist upon. Other circumstances besides war may have a similar effect in modifying the view taken of unprecedented taxation. The unemployment during the post war depression must have had some reaction on the attitude of the British taxpayer. The peril in which the finances of France were involved a few years ago undoubtedly made the people of that country more amenable to increased scales of taxation.

§ 10 A simple comparison of the pre war and post war ratios of taxation and expenditure in the chief countries of the world indicates that the rate of increase has been the greatest in the United Kingdom. In no other important country, judging from the few official returns, has the percentage of government expenditure more than doubled. In some of the late belligerent countries the increase has been no more than 10 per cent. Since the available data, however, are very limited, and their scope is by no means uniform, it is dangerous to draw too definite conclusions. We have already mentioned the complexities presented by differences in *per capita* incomes and in the respective burdens of national debts. Another difficulty may arise from the fact that local expenditure is not always included in the central government's publications, which are often the only records that can be obtained. The local authorities in one country may be responsible for heavier taxation and expenditure than they are in another. Some central governments give grants in aid to the local bodies, while others do not. Differences in the accumulated wealth, in the

relative purchasing power of money, in the character of the public services—these and many other circumstances prevent a really accurate comparison from being deduced from the scanty published reports

§ 11 Our findings with regard to the taxable capacity of a nation may be briefly summarised The principal test, it has been suggested, is the effect on the economic organisation of the country The main limit may be said to be exceeded when the productive powers of the taxpayers are in any way weakened No precise and universal definition, however, can be laid down, for what constitutes the limit in ordinary years may be altogether surpassed in times of emergency In this sense the conception of taxable capacity is purely relative

Subject to this qualification, we have shown that the taxable capacity of a nation is determined (1) by the character of the taxation itself, (2) by the number of the people in relation to the volume of production, (3) by the nature of the goods and services produced, (4) by the manner in which the national income is distributed, (5) by the purposes to which the revenues are applied, and (6) by political and psychological considerations which cannot be reduced to economic terms Some of these factors are measurable, others are very indeterminate Hence it is possible to state and compare the respective taxable capacities of different countries only in the most general terms

CHAPTER IV

EQUITY AND ECONOMY IN TAXATION

1 Ability to Pay

§ 1 A TAX is not a price, but a compulsory exaction in which there is no *quid pro quo* element Hence, as we have already explained, it is not correct to take the view that a tax measures the benefit conferred upon the taxpayer by the public authority The notion of making the beneficiaries of State and local assistance pay back an equivalent amount of money is unthinkable, while, even where it might be desirable to connect payment made and benefit received, we have not, as a rule, any means of computing the relationship with any degree of precision

It is equally fallacious to consider a tax as indicating the cost of the service rendered by the public authority This theory, which runs parallel to the benefit theory, is open to the same kind of criticism It is impossible to calculate the specific cost of providing individual taxpayers with the many services they receive from the central and local authorities The payments for such things as postal and tramway facilities, gas and electricity, and so on, are largely worked out on the basis of cost, but they are not

taxes in the proper sense. Only the surplus, if any, that is made by the public department can be regarded as coming within the scope of the term.

It is, then, both undesirable and impracticable to effect a distribution of the burden of taxation on either of the principles of benefit or cost. Indeed, if any such apportionment were adopted, there would be no occasion for stigmatising the charge as a "burden"; it is for the very reason that the tax-payers as a class cannot trace any connection between the amounts they are compelled to pay and the costs or the benefits of the services provided, that the idea of a burden develops. Taxation may or may not, according to the circumstances and the methods adopted, be of net advantage to the community as a whole, but there is no question of its being an incubus to particular sections of the people. The view arises, therefore, that the charge should be apportioned among the taxpayers in the most equitable manner that circumstances permit; that the "ability to pay" rather than the value of the services rendered should be the guiding consideration.

§ 2. The phrase sounds attractive, from the point of view of equity, but, when one attempts to embody the principle in a practical scheme of taxation, numerous difficulties arise. To begin with, what exactly does one mean by "ability"? Some, adopting what has been described as the subjective interpretation of ability, reduce the question to terms of personal sacrifice. Others prefer the so-called objective interpretation, and lay stress on the capacity or faculty, as measured by income and other criteria, to contribute to the public purse.

The real significance of the distinction between the two views may not be apparent on first examination, but it becomes evident as soon as one attempts to translate the rule of ability into practice.

The contention that ability to pay resolves itself into terms of sacrifice is very ambiguous, and is responsible for several different ways of defining the degree of "pain". One suggested principle is that of equal sacrifice, whereby the imposts would be distributed in such a way as to secure an equal real burden upon all the taxpayers. How an equality of burden is to be assessed, however, let alone attained, is not made clear. A second interpretation is that of proportional sacrifice, by which the burden would bear the same ratio to all incomes. A similar kind of criticism could be directed against the notion of proportional sacrifice. A third view, known as the principle of minimum sacrifice, is that the taxes should be so arranged as to impose the least sacrifice upon all the taxpayers. While the first two principles would require that everybody, rich and poor, should contribute something in taxation, the third principle does not necessarily imply such a wide distribution of the charge.[1]

On examination, the third principle is found to be just as vague as the others, for we have no more satisfactory means of estimating what is the least aggregate sacrifice than we have of knowing when sacrifices are equal or proportional. In fact, as Professor Seligman has said, "sacrifice denotes something psychical, something psychological. A tax takes away commodities which are something

[1] See H. Dalton, *Public Finance*, pp. 89-95 (6th edition).

material, something tangible. To ascertain the exact relations between something psychical and something material is impossible. No calculus of pains and pleasures can suffice, for no attempt to reduce the heterogeneous to the homogeneous can ever succeed."[1]

§ 3. We have to fall back, therefore, on the objective interpretation of ability to pay, which is judged simply by reference to people's income and other tangible evidences of their capacity to bear taxation. Strictly speaking, of course, the one conception cannot be dissociated from the other, for they both have regard to the same object. The faculty principle is chosen only because it lends itself more readily to a practical scheme. If one wishes to apportion the tax burden in an equitable manner, yet shrinks from evaluating and comparing the different degrees of sacrifice, one must accept such outward criteria of ability as present themselves. At the best the scales of taxation on this basis are arbitrary, but they can be made to conform, in a general way, to one's ideas of justice.

§ 4. The earliest instance of the use of "ability" is found in the Elizabethan poor law, which levied the charges "according to the ability of the parish". "Faculty", in its Latin form, appears still earlier in mediaeval documents. To the Elizabethans the criterion of ability to pay was the possession or occupation of property. Although in national taxation this source of taxation has long proved inadequate, it still furnishes most of the revenues of our

[1] See E. R. A. Seligman, *Progressive Taxation*, *Essays in Taxation*, and other works for criticisms of the "sacrifice" theories.

local authorities. We need not, for the present, go into the deficiencies of property as a criterion of ability, except to say that the method concentrates the burden at a few points, does not affect those prosperous citizens whose wealth takes other forms, hits the small property holder with a relatively greater severity than the large holder, and on the whole, as will be shown later, distributes the burden in a distinctly inequitable fashion.

§ 5. For a long time expenditure was regarded as a suitable object of national taxation, luxury articles being often singled out as affording an index of people's ability to pay. Taxation of this kind, however, is liable to be regressive, *i.e.* the percentage of one's income appropriated on this basis is apt to decline as the income goes up. We noted in the previous chapter that a person's taxable capacity tends to increase more quickly than his income, for the reason that his surplus over necessary expenditure increases at a faster rate. A man whose income is twice that of another derives, as a rule, less than twice as much utility; his taxable capacity is more than twice as great. But a tax on commodities is liable to place the greatest relative burden where the taxable capacity is the least, and to let off lightly those whose taxable capacity is the greatest. The man with twice the income of another does not, in general, buy twice as much beer, tobacco, and other articles usually chosen for taxation. The ratio of such duties to a poor man's income is much greater than that to a rich man's income, and to that extent the system of taxation is regressive.

§ 6. On the other hand, certain luxuries are

selected for taxation that do not enter into the poor man's budget, and to that extent the fault is rectified. The taxes on luxuries, however, are still far from being progressive in the full sense of the term. All well-to-do people do not go in for luxury expenditure. There is no evidence that, as a person becomes more and more prosperous, his expenditure on luxuries increases in still greater degree. Yet this is what we would expect of any taxes that were intended to keep pace with people's taxable capacity. There is the further objection that taxes on luxuries would not yield nearly sufficient revenue to satisfy the needs of modern governments. In addition, there are the administrative difficulties that beset a scheme for taxing luxuries on a large scale. Hence, taxation of this kind is liable to be criticised on grounds of inadequate yield and administrative cost, as well as on the broader grounds that, unless it is accompanied by some measure of direct taxation, it is certain to involve a very unequal distribution of the total burden.

The regressive character of most indirect taxes, however, must not necessarily be regarded as sufficient evidence for condemnation. It might be that the scales of direct taxation, if left unmodified by indirect taxation, would work out too progressively; that people with the larger incomes would be paying too much, and those with the smaller incomes paying too little. If the income-tax level were not lowered, many would, under such conditions, be paying nothing at all. The general opinion is that everybody, rich and poor, ought to pay something, if only to promote a greater degree of civic and social con-

sciousness, and to make everybody have an interest in restricting unnecessary public expenditure. It has to be admitted, however, that a large proportion of the poorer classes who pay indirect duties are really taxed "in the dark". It is surprising how few people know the full extent of their tax payments. Further, the connection between tax obligation and political interest is not as strong as the argument makes out. Those who have to pay largest sums are not by any means the most politically minded.

So long as indirect taxation continues—and for administrative reasons if for no others it is likely for some time to retain its place in our fiscal system—there is bound to be some regression, which can be defended only if the direct taxes show a more than countervailing degree of progression. The system of taxation as a whole may be distinctly progressive, notwithstanding the regressive nature of individual taxes. These duties may be retained for purely practical reasons, which a Chancellor cannot afford to ignore. Graduation of the duties on different qualities of articles can be carried out only to a limited extent, while their graduation according to the income of the purchaser is entirely out of the question. Expediency has sometimes dictated a lower scale of taxation as the price of the article or service increases. For example, the dearer seats in a theatre are subjected to a smaller proportionate tax than the cheaper seats. If, however, the tax on the dearer seats were raised, some of the patrons might thereby be induced to favour the cheaper seats, or even stay away altogether. From a sumptuary point of view this might not be a bad thing, but the

Chancellor would be mainly concerned with the falling-off in revenue. However much one favours the general principle of equity, one cannot overlook the important consideration of yield.

2. Progressive Taxation

§ 7. A scheme of taxation that is to conform with the principle of equity must be progressive in character. As people's ability to pay goes up, as a rule, in a quicker ratio than their incomes, the percentage taken from them in taxation should, in theory, increase in corresponding degree. How is this progression to be achieved? An obvious first step is to leave everybody a minimum income free of taxation, the minimum to be measured by the smallest amount of those commodities required to keep a man and his family in a proper state of health and efficiency. It will be recalled that only the surplus over this amount constitutes the true taxable capacity of the individual. If the minimum is not left free of taxes, a large number of people suffer unduly and the nation experiences a falling-off in the volume of production. But, as we have already pointed out, we have no definite knowledge of what this minimum standard consists. It varies from one taxpayer to another, even within the same social class and range of income. It varies from time to time for the same individual according to changes in income and expectations. What is regarded as the minimum standard in ordinary years may be willingly cut down in periods of emergency. The only absolute minimum that can be obtained is that which furnishes just sufficient

food, clothing, and shelter to keep one alive, and we have, fortunately, got beyond the stage of taking this as the basis.

§ 8. In our fiscal system the scheme of direct taxation permits of a minimum free income, but the indirect taxes cover the whole field. Several articles consumed by even the poorest classes are subject to duty, and to this extent, it might be said, the scheme as a whole fails to satisfy the condition. In opposition it might be contended that, in estimating minimum wage rates, so far as these are directly or indirectly related to the cost of living, the addition of the tax to the price of the articles is taken into account, and that therefore the minimum free income still remains. This argument, however, does not apply to those wages and other forms of income, such as annuities and pensions, that are not specifically governed by the prevailing purchasing power of money, and therefore do not contain any allowance for an increase in commodity duties. There is, too, the submission, the limitations of which we have just noted, that everybody, whatever his income, ought to pay something in taxation. But evidently there must be a minimum somewhere below which it is undesirable, if not impossible, to make any net exaction.

Here again expediency may result in anomaly. From the above reasoning it might appear justifiable to exempt, for example, the old age pensioners from the taxes on food and other necessaries. But it would be clearly impossible to differentiate between the taxes imposed on people with 10s. a week and those with £1 a week, or, for that matter, £100 a

week. Graduated scales of commodity taxes are, with few exceptions, impracticable. If the pensioners, already impoverished, are to be freed from the burden of these taxes, the only alternatives are entirely to abolish such means of revenue or to add some compensation to the existing pension, either in money or in kind. The second alternative seems roundabout and anomalous, but it is more expedient than abolishing the indirect taxes for everybody. The present old age pensions are admittedly slender; yet if the taxes on food did not exist, it is conceivable that the payments would be even smaller.

§ 9. Reverting to the income tax, we find that the exemption below a given line provides the first stage in a scheme of progression. Even if all incomes over that line were taxed at a flat rate, as used to be the case, there would still be a certain progression as between the exempted and the taxed incomes. Thus, proportional taxation can, within limits, attain a certain degree of progression. But the days when one had to be well off before being required to pay income tax have gone by. The number of allowances has, it is true, been increased, but the exemption level has been reduced, notwithstanding the serious depreciation in the purchasing power of money.

There are still some "die-hards" who hanker after a proportional system, in the belief that this works out the most equitably. Some of them refer to the well-known maxim of Adam Smith: "The subjects of every State ought to contribute towards the support of the Government, as nearly as possible,

in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the State". The emphasis that they give to the term "proportion" is, however, mistaken, for Smith did not intend his canon to suggest a flat rate for everybody. In another part of his *Wealth of Nations* he considered it to be "not very unreasonable that the rich should contribute to the public expense not only in proportion to the revenues, but something more than in proportion". Those, therefore, who still favour proportional taxation must look elsewhere for support.

§ 10. It is interesting, incidentally, to note the change-over in the attitude to proportional taxation. Nowadays it is regarded as an inadequate means of apportioning the burden, as being likely to result in serious hardship to the bulk of the population. When it was first advocated, however, the motive was similar to that now attributed to progressive taxation—to spread the burden more equitably. In former times there were favoured classes who were exempted from taxation, or, where they were at all liable, were required to pay very little more than the rest of the people. It was considered that, if they could be brought to pay in the same proportion as the less fortunate classes, a great advance in the scheme of taxation would be achieved. It is significant of the change in the times that what was originally regarded as a revolutionary step in securing an equitable apportionment fails altogether nowadays to satisfy our ideas of justice.

The only adequate method, then, is to impose an increasing rate on incomes over the statutory exemp-

tion limit. Such a method, in a moderate form, was adopted in the United Kingdom in 1909, but since then, mainly as a result of the war, the steepness of the graduation has been considerably accentuated.

§ 11. Various tests of ability to pay, apart from gross income, are applied. No scheme would be equitable if it did not make allowance, for example, for family obligations, and for capital depreciation. Numerous abatements of this kind are to be found in practically all systems of direct taxation. The question of making some special concession to "earned" as opposed to "unearned" incomes has received much attention, and has, to a certain extent, been favourably regarded by the legislature of this country. There is a twofold argument for taxing earned incomes at a lower rate than unearned incomes. In the first place, it is maintained on grounds of equity that a man who lives by his personal services to the community should receive some measure of preference as compared with a man who lives by the ownership of property. The reasoning is by no means complete, especially in regard to the nominally unearned incomes from investments, to acquire which the owner may have worked hard in former years.

In the second place, it is contended that the recipient of an income from investment has actually a greater immediate spending power, for he is not under the same obligation to save as the man whose income depends on his direct earnings. The investment income is not terminable at death, and the recipient need not, apart from the liability to death

duties, make provision out of current revenue for maintenance of his dependants in the event of his early demise. The earned income, however, is terminable, and the recipient has, as a rule, to set aside a certain proportion to provide for the above contingency. In short, the free income of the latter is less than that of the former, and, if the same scales of taxation were imposed, the respective burdens would be unequal.[1]

The abatement on insurance premiums helps to meet the difficulty, but only in a small way. More effective is the deduction of the statutory proportion of earned income before the assessable amount is obtained. It is often urged, however, that the prevailing rate of differentiation is not sufficient; that a much more generous allowance should be made to the earned income receivers, if the total charge is to be fairly apportioned.

§ 12. Although it is easy to discover defects of this character, it cannot be denied that the principle of progression is applied more thoroughly now than ever before, and that, having regard to the enormously increased aggregate burden, there is greater equity in its distribution among the several ranges of income. The advance that has been made since the beginning of the century is well illustrated by the tables, contained in the Colwyn Report of 1927,[2] relating to the total of direct and indirect taxation to specimen incomes. For purposes of comparison at

[1] See also below, pp. 186-187, where it is argued that the death duties help to rectify the insufficient differentiation between personal earnings and investment incomes.

[2] See Appendix, Tables VII and VIII, for more complete statistics.

different times the taxpayer is assumed to be married and to have three children under the age of 16. In the financial year 1903–4 a man with a wholly earned income of £100 paid no direct taxes, but 5·6 per cent of his income in indirect taxes. The same income, half earned and half investment, was subject to 1·2 per cent direct taxation, bringing the total to 6·8 per cent. As the income rose, the percentages taken in taxation declined (though not evenly), the regression in the case of wholly earned income being particularly marked. Thus, a man with an earned income of £1000 paid a total of 6·1 per cent, while one with an earned income of £50,000 paid only 4·8 per cent. The corresponding ratios for half-earned, half investment income were 7·8 per cent and 8·0 per cent. (The proportion of indirect taxation on the largest incomes was only 0·1 per cent.)

By 1913–14 there was some improvement. The man with £100 a year earned income paid a total of 5·4 per cent. An earned income of £1000 was liable to 5·2 per cent, but the ratio rose to 8·4 per cent on an earned income of £50,000. The progression was rather more noticeable in the case of the half-earned, half investment incomes, being 6·6 per cent on £50, 8·3 per cent on £1000, and 13·6 per cent on £50,000.

In 1918–19 the ratios were as follows: Wholly earned: 9·9 per cent on £100, 16·9 per cent on £1000, and 50·6 per cent on £50,000. Half earned, half investment: 11·1 per cent on £100, 20·6 per cent on £1000, and 58·2 per cent on £50,000.

The percentages for 1925–26, the latest year quoted, are set out in greater detail on the following page.

The ratios in this table are very instructive. It will be noted that, although there is a distinct progression between the two extremes, there is a certain amount of regression between the £200 and the £1000 levels. A similar decline is noticeable in the tables

Income 1925–26.	Total Taxation—Percentage of Income.					
	Income wholly earned.			Income half earned, half investment.		
	Direct.	Indirect.	Total.	Direct.	Indirect.	Total.
	Per cent	Per cent.	Per cent.	Per cent.	Per cent.	Per cent.
100	..	11·9	11·9	1·1	11·9	13·0
150	..	11·6	11·6	1·1	11·6	12·7
200	..	10·2	10·2	1·1	10·2	11·3
500	2·0	4·2	6·2	4·2	4·2	8·4
1,000	8·1	2·9	11·0	11·5	2·9	14·4
2,000	13·2	2·0	15·2	17·3	2·0	19·3
5,000	21·9	1·3	23·2	28·2	1·3	29·5
10,000	30·0	1·2	31·2	38·9	1·2	40·1
20,000	36·9	0·6	37·5	48·1	0·6	48·7
50,000	44·2	0·2	44·4	57·5	0·2	57·7

for previous years, but not always in the same degree. The total taxation on earned incomes falls from 10·2 per cent on £200 to 6·2 per cent on £500, and rises to 11 per cent on £1000. The corresponding ratios on half-earned, half investment incomes are 11·3 per cent, 8·4 per cent, and 14·4 per cent. While few would assert that the £500 a year man is being taxed too lightly, there are many who would argue from these figures that the £100 a year man is being taxed far too heavily. Though the position is partly modified by the relatively greater advantage which the poorer man obtains from the public social services, the element of regression in the smaller incomes is not on that account entirely overcome.

3. The Principle of Economy

§ 13. The famous canons of Adam Smith have done yeoman service, but, it is to be feared, they have had a somewhat cramping effect upon later writers on public finance. For nearly a century they were commonly regarded as the last word on the principles of sound taxation, and even to-day, over 150 years from the publication of the *Wealth of Nations*, they are frequently given first place in the text-books. But it cannot be taken as a disparagement of a work written in the eighteenth century to say that it fails in many respects to prescribe for the twentieth. In the sections dealing with pure economic theory the book is, in many places, recognised as being obsolete, yet the maxims of taxation are still commonly quoted as if they were definitive and applicable to all times.

We have already had occasion to note that the best-known of Smith's canons—that of "equality" —suffers from ambiguity. His other canons, namely, those of "certainty", "convenience", and "economy", which were intended to be administrative rules rather than fundamental principles, are to be criticised, not for their lack of sound advice, but rather on the score of incompleteness. The rule of economy, in particular, can be extended to cover a much wider ground than that contemplated by the author.

There can be no disagreement with the last-mentioned of these canons that "every tax should be so contrived as both to take out and keep out of the pockets of the people as little as possible over and

above what it brings into the public treasury" The "leakage", for example, to which Adam Smith drew attention, is not nearly as considerable nowadays as a century ago, and if that were all against which the canon of economy was directed, it could be said to have practically achieved its purpose There are still some indirect taxes, it is true, which permit of the middlemen making an extra profit Thus, a duty of 1s per lb on a commodity is liable, in the absence of a more divisible coinage, to send up the price by 1d per ounce Our scheme of taxation as a whole, however, is not unsatisfactory so far as "leakage" of this kind is concerned

But the implications of economy, even in the strictest sense, are wider than this It goes without saying that the cost of collection should be the minimum amount consistent with efficient administration The income tax is one of the cheapest of all taxes to collect, the expense having averaged about 30s per £100 The excise and customs duties cost, in general, about 2 per cent to collect, though certain duties entail an even greater ratio The percentage of expense to revenue, taken as a whole, however, compares very favourably with that in other countries

§ 14 The large "turnover" of the British Exchequer, and the small administrative cost, give point to those other maxims which were formulated by later writers, but which can, perhaps, be included in Smith's canon of economy The first is that of automatic increase in yield The public financier naturally prefers a tax which, as the population and income of the country increase, produces a larger revenue,

to one which gives a more or less constant yield. Thus, a tax on incomes or on articles of everyday consumption is likely, in a growing community, to yield a greater return year by year, even though the standard rate remains unaltered. A tax on land (as distinct from land values), on the contrary, is unlikely to give a larger revenue except by increasing the duty itself.

The second of these subordinate maxims is that of elasticity. A tax which can be increased, as occasion requires, with a corresponding expansion in the revenue, is viewed with greater favour than a tax which provides a fixed or even a diminishing yield. The position with regard to indirect taxes is easily stated. A tax on a commodity which is itself subject to a sensitive demand is unlikely to be elastic in its return; and *vice versa*. The demand for wine or cigars is very sensitive, being liable to a marked decrease or increase as the price goes up or down. An addition to the duty beyond a certain point is likely to cause the demand to fall off to such a degree that the resultant revenue declines. This actually happened a few years ago, when an addition to the cigar duty caused such a decline in the yield that the tax was reduced again in the immediately following Budget.

The elasticity of a direct tax is determined by a more complicated set of conditions, which we shall have to examine more closely at a later stage. For the present we need only say that, if the tax has already reached such a level that it leaves the taxpayer just sufficient inducement to continue to produce, an increase in the tax beyond this level is

liable to restrict the volume of income and therefore to cause the revenue from this source to decline.

Provided that a tax is elastic within wide limits, and especially if it yields an automatic increase in revenue quite apart from a higher rate, there is some force in the further rule, which we sometimes come across, that it is better to have a small number of highly productive taxes than to have a large number of less productive taxes. The comparatively small cost of raising the British revenues is in part due to the fact that the bulk of the money comes from very few duties.

During the last few years, however, there has been a large addition to the number of taxes in this country. Some of them have been imposed for avowedly protectionist purposes, and therefore, whether the object has been attained or not, cannot, properly speaking, be subjected to the present tests. The less revenue they yield, the more is the true protectionist pleased. The majority of the new taxes, however, have been devised for the purpose of swelling the funds of the Exchequer, and have in most instances succeeded in their aim. But whether the aggregate revenue could not have been increased by raising the existing taxes and not resorting to new ones is an open question. If the money obtained from the new indirect duties could have been derived instead from an addition to the income tax or surtax, there is little doubt that the ratio of the cost of collection would have been smaller.

§ 15. Little need be said on the canons of "certainty" and "convenience" to which Smith gave such prominence. They, too, have lost much of

their former significance, not because they are proved faulty, but because the evils against which they were directed have been to a large extent removed. "The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor and to every other person." Most of our present-day taxes conform to this rule, although important exceptions are not lacking. The improvement that has taken place can be judged from the remark with which Smith supplements his rule. "The certainty of what each individual ought to pay is, in taxation, a matter of so great importance, that a very considerable degree of inequality . . . is not near so great an evil as a very small degree of uncertainty." The fiscal machinery must have been very imperfect in those days to warrant such an assertion. Certainty is still, of course, an important requisite of taxation, but it is overshadowed by the other maxims.

Similarly the rule of convenience must be placed in a minor position. "Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it." There will be no disagreement with Smith's assertion, regarding taxes on luxuries, that the consumer "pays them by little and little, as he has occasion to buy the goods. As he is at liberty, too, either to buy, or not to buy, as he pleases, it must be his own fault if he ever suffers any considerable inconveniency from such taxes." This was written, of course, in the days when the burden of taxation was comparatively light, and when it was thought possible to raise a large proportion of the required

funds from the fringes of expenditure, the cutting down of which would not seriously embarrass the people as a whole. But only the most optimistic could hope, at the present time, to provide the Exchequer with the necessary revenue without inflicting great inconvenience upon the taxpayers. The most one can hope for is to render the operation as painless as circumstances will allow.

It is not stretching the term to make economy, as an administrative rule, include the several other conditions that we have mentioned. The more elastic a tax, and the more certain and convenient the mode of its assessment and collection, the more economical is the organisation bound to be. There will be less need to create new taxes and staffs of officials if the existing taxes and machinery can be made to yield a greater return. There will be less trouble and expense in defining and enforcing the amount of individual obligations if, to begin with, the nature of the tax is properly set out and, so far as possible, the convenience of the taxpayer is taken into account.

§ 16. The principle of economy, however, can be shown to be even more comprehensive. Not only must the taxing authorities have regard to the cheapness of collection, but they must also consider the effects on the economy of the nation as a whole. Thus, the canon of economy may be interpreted so as to lay down that a tax should interfere as little as possible with the productive capacity of the taxpayers. In this sense it is more than a simple administrative rule: it becomes a fundamental principle of taxation. Smith was not unaware of this application of

the canon of economy. He says that the levying of a tax "may obstruct the industry of the people, and discourage them from applying to certain branches of business which might give maintenance and employment to great multitudes. While it obliges the people to pay, it may thus diminish, or perhaps destroy, some of the funds which might enable them more easily to do so." But, as he hides this truth among less important considerations of expensive official staffs and possible inducements to smuggling and evasion, the significance of the wider version of economy is liable to be overlooked.

In the narrow sense a tax may be economical to collect, but in the broader sense the consequences may be the reverse of economical. For a time, no doubt, a standard income tax of fifteen shillings in the pound would yield an enormous addition to the revenues, with a relatively low expense of collection, but the effects on enterprise and saving would be such that the volume of production would soon fall off and the Exchequer, as well as the taxpayers, would be impoverished. The high "productiveness" of the tax would turn out to be very unproductive in its consequences. Thus, a low cost of collection and a high yield, while both are desirable in themselves, do not necessarily make for real economy. The wise Chancellor therefore pays regard, not merely to the immediate return and the expense of obtaining it, but to the ultimate reactions on the economic organisation of the community.

§ 17. Viewed in this light the principle of economy cannot be dissociated from the principle of ability. We observed, when dealing with the subject

of equity in taxation, that it is not practicable to reduce ability to terms of personal sacrifice. Faculty, as indicated by income and other criteria, is more measurable than sacrifice. In estimating a person's faculty, however, we must give our attention to the probable effects of a tax on his powers of production, for by them, eventually, is determined the size of his income. For instance, in discussing the equity of taxes on wage-earners, we cannot avoid inquiring into the reactions of a reduced standard of living upon the efficiency of labour. In examining the equity of a tax on interest, we must also study the possible effects on future accumulations of capital. The principles of equity and economy, therefore, cannot be considered apart. Although on occasion there may be an apparent conflict between the two principles, when the Chancellor almost invariably inclines to the alternative that yields the largest immediate revenue, they must both hold a prominent place in a well-conceived system of public finance.

CHAPTER V

GENERAL PRINCIPLES OF INCIDENCE

1. The Form and Measurement of Incidence

§ 1. It will bear repetition, perhaps, to emphasise once more the necessity of distinguishing between the incidence and the effects of taxation. Under the head of incidence we ask, Who actually bears the money burden of a tax? Under the head of effects we ask, What are the ultimate economic conditions to which a tax gives rise? In studying the practical problems of particular taxes it is sometimes very difficult to separate the two questions, especially as the nature of the incidence may have a considerable bearing on the determination of the ultimate effects. But the distinction has to be made if one wishes to obtain a clear view of the distribution of the money burden of taxation. Many of the uncertainties and ambiguities in earlier writings would have been avoided had the two conceptions been kept apart.

The view used to be common, and, indeed, is encountered occasionally even now, that a tax, though it may tend to stick for a time at or near the place where it is first imposed, is eventually shifted

and shifted again until it spreads itself over the whole of the people, whether they are called upon specifically to contribute to the State or not. The "diffusion" theory resolves itself into the belief that, in the long run, it does not matter what form a tax may take or what methods are adopted for its collection. It is sure to rebound from one person to another, until, in the end, everybody participates in the burden.

This theory, however, is very shallow and misleading. It is shallow because it avoids the real difficulties, considering it hopeless to trace the incidence of a particular tax. It is misleading because it assumes a state of perfect mobility and competition which is far removed from actual conditions. And, in so far as it gives the impression, as it is calculated to do, that all taxation is diffused until the burden of everybody is more or less the same, it beguiles the unthinking into an over-optimistic and insidious belief that, whatever form taxation may take, all must come right in the end. "What is the use", it might imply, "of studying the pros and cons of individual taxes? For the present they may hit one class of people, but ultimately they must be borne by the people as a whole. Therefore do not trouble about a just apportionment of the burden, but let all efforts be concentrated on the matter of yield." The dangers of such an attitude are too evident to need any comment. But, more pertinent from our present standpoint, this supposed theory of incidence is, in effect, a confession of ignorance. Its supporters find themselves unable to follow the path taken by particular taxes, and

merely make a wild guess as to the ultimate destination. The guess turns out to be far from the truth. The incidence of taxes presents, in fact, some of the most complicated questions in applied economics, and cannot be disposed of so easily as the "diffusion" theorists would suggest.

§ 2. It will, perhaps, make the subsequent analysis clearer if at this stage we make some preliminary observations on the direction of shifting, the form which it takes, and the manner in which it is measured. Usually we expect a tax to move forward, and this is, in fact, the rule when it is placed upon a commodity that enters into exchange. Whether the whole of the duty is so transmitted depends on circumstances that we have still to examine, but the general tendency for the shifting of such a tax to be in a forward direction from the seller to the buyer needs little demonstration.

The economic position of the person who bears the impact of the tax has some bearing on the problem. If he is normally engaged in buying and selling the commodity which is the subject of the tax, he will immediately try to pass the charge on to his customers ; if this is impracticable, he will endeavour to shift it backward to the producers. He is better placed strategically than either of the parties at the two extremes, for if he experiences difficulty in one direction he can try the other. Backward shifting is not so easy to accomplish as forward shifting, but, as we shall observe, it is by no means rare.

§ 3. In certain cases shifting can take place without any outward change in the price of the commodities concerned. Rather than risk friction with

the public, manufacturers may decide to reduce the quality or size of the articles which they sell. Where the tax is specifically upon these commodities, there is usually no difficulty in passing the whole of the burden on to the consumer, for he presumably knows of the duty, at any rate for a little time following the Budget speech, and is in a better frame of mind to pay it. But if the tax is more hidden (if, for instance, it is upon one of the raw materials), the producers may prefer a policy of cutting down the quality or quantity of their goods, leaving the selling price apparently unaltered.

It may happen, on the contrary, that the price goes up by the full amount of the tax, yet part of the total burden remains with the seller. The latter has to lay out a larger capital sum for his stocks. Perhaps, at the higher price, he suffers a reduction in his sales. He may be disposed, by way of compensation, to add something to the price over and above the amount of the tax, but be prevented from doing so by competition and other factors.

Or it may be that the price rises by more than the amount of the tax because the currency is not sufficiently divisible to allow of an exact contribution by the consumer, and the seller is not likely in ordinary circumstances to add less than the amount of the tax. The round figure he charges is the upper, not the lower, limit. Thus, for example, a tax of (say) 4d. per dozen boxes of matches probably raises the price by ½d. per box if bought separately.

Considerations of incidence and effects are here rather difficult to distinguish. To the extent that the seller suffers a diminution in the volume of his

business or has to bear a larger interest charge on his capital, the problem is really one of effects. Suppose that the tax is 1s. and that the extra charge for interest and other items works out at 1d. If the price goes up by 1s. 1d. the consumer bears the whole of the tax and also pays the additional costs that have been entailed. If the price goes up by 1s., the incidence in its strict sense is upon the consumer, but actually 1d. is being contributed by the seller. The amount that he loses, however, belongs to the computation of effects. If, for one reason or another, the price goes up by only 9d., then the incidence to the extent of 3d. is upon the seller, in addition to the other burden of 1d. It is desirable, in tracing and estimating the incidence and effects, to keep the 3d. and 1d. separate, although the seller is naturally apt to regard his contribution in the aggregate and not to analyse it into its constituent parts.

Conversely, price movements may coincide with variations in the rate of taxation, yet be attributable in part to altogether different factors. There may be alterations in the supply of and demand for the particular articles, causing independent fluctuations in prices. External forces, affecting prices in general, may also be at work. The fact that the price of bread rose slightly in the few years following the repeal of the Corn Laws did not prove that the free trade measure to reduce its price had failed. For reasons largely connected with gold discoveries and other monetary conditions, all prices were rising at this time. Relative to the general price level, and to the increased money incomes, the price of bread hardly rose at all, and there is little room for doubt that,

if the Corn Laws had not been repealed, it would have soared to a considerably higher level

Similarly, one cannot measure the exact incidence of a tax on imported articles such as motor cars by comparing the prices at dates before and after the imposition of the duty All sorts of factors enter into the determination of motor car prices many of them entirely independent of, and much more important than, changes in the scale of taxation Following the re imposition of the "McKenna duties" the prices of some foreign cars increased while those of others declined Obviously, reasons other than taxation were largely responsible for the price movements This argument goes to show the imprudence of relying on price statistics for a reliable guide to incidence In no other branch of applied economics must figures be used with greater caution

2 Conditions Inherent in the Tax

§ 4 In dealing with problems of incidence there is, perhaps, a tendency to concentrate on the objects on which taxation is levied and to ignore those factors inherent in the taxes themselves Yet it may happen that the shifting is hampered and even prevented by the design and structure of a tax, quite independently of the nature of the article chosen as the medium

Whether, for example, a tax is exclusive to a particular commodity or whether it is laid upon a whole class of commodities, has some bearing upon its incidence Some commodities are found in alter

native demand (*e g* tea and coffee), and a rise in the price of one of them may cause part of the custom to be transferred to the other If a tax is imposed on one of these articles, the seller will not necessarily increase the price by the full amount of the tax, for fear of the demand being diverted to the untaxed article Hence, it may be generalised that a tax which is common to all commodities of a certain class is more liable to be shifted than a tax which is exclusive to a particular commodity in that category

§ 5 The magnitude of a tax is often an important consideration in the determination of its incidence Where a tax is of large dimensions, there cannot, as a rule, be any question of the seller paying the whole of it, although he may, for various reasons, be compelled to bear part It would be manifestly impossible for the whisky distillers to pay the whole of the spirit duty But, where a tax is of small amount, the force of circumstances may be strong enough to make the burden rest upon the seller Every time a trader increases his prices there is a certain amount of trouble and inconvenience to all parties, and possibly, if the duty is not specifically imposed upon the particular goods offered for sale, some resentment on the part of the buyers is liable to be aroused The more competitive are the conditions of sale, the greater is the disinclination of individual traders to raise their prices, and risk a falling off in their business

It might be maintained, on the contrary, that if only a slight change in price were involved, the aggregate demand would be unlikely to fall off, and therefore the seller would not have such hesitation

in attempting to shift the tax as the above reasoning would suggest The truth of this contention is not questioned, provided that all the sellers acted together They might put up their prices without actually coming to a formal agreement to do so But if some of them, endeavouring to gain an advantage over the others, decided to bear the tax themselves (and, needless to say, well advertised the fact), the competitors who persisted in charging more for their goods might suffer a marked reduction in their sales Though consumers might, if really pressed, pay, say, 5 per cent more for their requirements without cutting down their orders, they would not ordinarily, on that account, remain faithful to their usual tradespeople if they could buy more cheaply elsewhere

§ 6 The shifting of a commodity duty is also influenced, though not perhaps to a great extent, by the form which the duty takes The tax may be either "specific" or "*ad valorem*" If all grades of a commodity have to bear the same duty, irrespective of their individual costs, it may be that the makers and sellers of the cheapest grades find it physically impossible to bear the duty, for the ratio of tax to profit per unit is altogether excessive If they are to continue to sell their goods the prices must go up by the amount of the tax In this event the incidence is clear If, however, owing to market conditions, prices cannot rise sufficiently to make up for the duty, the makers of the lowest-priced grades may have to cease production, and so bring about a shortage of supplies in the aggregate The result is likely to be an increase in prices and the transfer

ence of the tax to the purchasers This, it is true, would be an instance of long run effects rather than of straightforward shifting, but from the standpoint of the buyer the outcome is the same

Where, however, the tax is apportioned to the value of the commodity, the makers of the cheapest grades have not to bear such a high ratio of duty to profit per unit If at all possible they increase their prices by the amount of the duty on their products, but, since this duty is lighter, they do not suffer so much as in the other set of circumstances, if they are compelled to bear the burden themselves It would appear, therefore, apart from all other conditions, to be somewhat easier for a specific than for an *ad valorem* duty to be transmitted

The same conclusion can be reached by a different mode of reasoning, this time with the consumer as the starting point If the duty is specific, the lower-priced goods of the group have to bear the same duty as the higher priced goods If the prices of the different grades, before the tax is added, represent their respective utilities to the consumer, it is obvious that the addition to them all of an equal amount will result in the purchaser of the superior grades getting better "value" for his money than the purchaser of the inferior grades If, for example, the net prices range from 1s to 1s 8d, and a specific tax of 4d is placed on each unit, irrespective of quality, the 33 per cent addition to the cost of the cheapest grade as compared with the 20 per cent addition to the dearest grade is almost certain to make the purchasers of the lowest priced goods reconsider the position, and may indeed induce them to change over

to a grade of a better kind The resultant diminution in the demand for the cheapest brands may cause them to go out of production The contraction in the aggregate supply would thus strengthen the position of the sellers of the superior grades, who might conceivably, at least for the time being, raise their prices by even more than the amount of the tax

Where, however, the tax is of the *ad valorem* type, the cheaper brands would not be penalised in this way, and the purchasers would not be encouraged to transfer their demand to the other brands Demand and supply would remain on more even terms, and the tendency for prices to rise would not be so pronounced The opportunity of shifting the tax, therefore, is not quite so favourable in the case of the *ad valorem* duty as in that of the specific duty The probability is that the duty in either of its forms will be shifted, but the tendency for the specific duty to be transferred is, if anything, the stronger

§ 7 Although we shall not be in a position to trace the incidence of the income tax and similar duties until the general conditions of price determination have been observed, it is relevant to point out here that the capacity for progression, inherent in such taxation, has some influence upon its incidence Like a specific duty on commodities a proportional income tax is liable, in the lowest ranges of income, to be shifted If everybody had to pay a fixed percentage of his income in taxation (there being, under a strictly proportional scheme, no allowance at the lower end of the scale), those whose minimum requirements for efficient production were encroached upon would tend to shift the duty backward to the

people who employed them, or forward to the people who bought their products. Manufacturers who were making the smallest profit consistent with their continuance in business could not pay a proportional duty, the rate of which was calculated by reference to average profits, but would either pass on the tax in one direction or another or go out of production. A progressive tax, on the other hand, would not be shifted, even in the lower ranges, with the same facility. The producers on the margin of existence would not be required to pay at the same rate as those making large profits, and therefore would not be impelled to raise their prices or drop below the margin. Such considerations would suggest that the more progressive is a scheme of taxation, the more likely are the duties to remain where they were first imposed. On this point more will be said later.

3. Conditions Inherent in the Object Taxed

§ 8. Taxes are, of course, placed in reality upon persons and not upon things, but the nature of the money burden, and the extent to which it can be transferred, depend to a large extent upon the character of the objects that serve as media. A tax calculated according to income is shifted, if at all, in a different manner from a tax placed upon commodities. The income tax is not intended to be shifted, and the taxpayer by his very position finds it difficult to transmit the burden. If he is a manufacturer or a trader he may endeavour to raise the price of his goods, but, as we shall show later, this is but rarely practicable. If he draws his income as

salary or as dividend on investments, and attempts to pass on the charge, he encounters even greater obstacles.

Taxes on commodities, on the other hand, are usually intended to be transmitted. There are certain forms of property, such as motor vehicles, the ownership of which is regarded as evidence of ability, and on which a recurring annual duty is payable. This class of taxation is direct in nature. But the excise and customs duties stand in a different category. Even if the authors of these duties had vague hopes that the makers and middlemen would bear the cost, the fact that the articles concerned enter into exchange would considerably facilitate the shifting. The machinery for the transference of the tax is already present.

§ 9. Excise and customs duties themselves vary in their power of shifting according to the relative position of the taxed commodities in the different stages of production. When commodities are used up in the furtherance of production they are known as producers' goods. When they are bought for the purpose of directly satisfying people's wants they are known as consumers' goods. It is evident that a tax on producers' goods can be shifted more readily than a tax on consumers' goods. At each stage in production there may be an opportunity of transmitting it; and the addition to the price of the final product is likely to be greater than the original amount paid in tax. But the "final" consumer of a taxed commodity is, as it were, at the end of the chain of production. The tax is transferred from the trader to him, and there it tends to stay. The only way for

him to lighten his burden is to shift the tax backwards, and this is very difficult to accomplish.

§ 10. Where the tax is of a recurring nature, the incidence is in part determined by the degree of durability that the commodity possesses. When a person contemplates buying some property he naturally takes into account the annual taxes that will have to be paid thereon, and the price he offers is less than it would be if no such charges had to be met. The price tends to be the value of the property less the capitalised amount of the tax. The more durable is the object taxed, the greater is the tendency to "amortisation".

Thus, the owner of such property at the time when the tax is first devised suffers a double loss. His income is diminished by the amount of the tax, and the value of his property is diminished by the capitalised value of the annual exaction. The incidence of the tax is said, by the holders of the amortisation theory, to be entirely upon the original owner of the property, for a subsequent owner who purchases it from him is considered to buy himself free of the tax in perpetuity. The annual payments that have still to be paid to the State are said to be balanced, in effect, by the interest from the capital sum that is saved when the property is acquired, and, therefore, do not represent a net charge at all. This plausible idea of a tax that is not a real burden will be examined more closely when we come to examine the taxation of land and other forms of durable property.[1]

[1] Pp. 268-270.

4 ELASTICITY OF DEMAND AND SUPPLY

§ 11 The conclusions that we have reached so far all turn on, and are liable to be modified by, the sensitiveness of the demand for a commodity following an increase in price The elasticity of demand is one of the chief factors in most problems of incidence, and the influence it exerts is greater than that arising from the nature and form of the tax itself

It is customary to illustrate the elasticity of demand by reference to articles of luxury and need For the former the demand is said to be elastic, for the latter, inelastic Strictly speaking, this is not quite correct Those who are so affluent as to be able to afford the most costly luxuries are unlikely to restrict their purchases should the price rise by a moderate amount Some, indeed, buy them for the very reason that they are expensive, and would not acquire and treasure them if they were cheaper More numerous, however, are those who are just in a position to afford the article at the original price, and who, after the imposition of the tax, refrain from purchasing

The demand for necessaries, on the other hand, is not so inelastic as is sometimes supposed Those who, after providing themselves with the essentials of life at the original prices, had a small surplus left would, for the most part, after the rise in prices, still purchase the same amount of necessaries as hitherto But those whose income was barely adequate before would now be compelled to cut down their expenditure on those articles for which the need was

least insistent. "Necessaries" and "luxuries" are relative terms, and what may be befitting to one set of circumstances may be quite inappropriate to another. Subject to these qualifications, however, we may accept the generalisation that the demand for luxuries is elastic and that for necessaries is inelastic, and the implication that a tax on the former is less likely to be shifted than a tax on the latter.

§ 12. The demand for a commodity is liable to be rendered more elastic by the presence of substitutes. If, as we have already explained, all the commodities within the group are subject to tax, we must consider the elasticity of the demand for them as a whole. But if a substitute is left untaxed, or is taxed at a lower rate, the demand for the first product is likely to be very elastic on that ground alone, independently of the sensitiveness that may be attributed to the character of the commodity itself.

It may provisionally be stated, then, that a tax on luxuries tends, in general, to raise their price by a smaller amount than a corresponding tax on necessaries. Also, a tax on commodities that compete with untaxed substitutes is more difficult to shift than a tax which is levied upon the whole range.

These conclusions, however, have reference only to the forces on the side of demand. It can be shown by a similar mode of reasoning, that the more elastic is the supply, the greater is the bargaining power of the seller, and the easier it is to transmit the burden to the buyer. Thus, if a tax is placed on a commodity that is capable of being increased

or diminished in supply fairly quickly (and especially if consumption is rapid, keeping pace with the rate of production), the producer will be able almost immediately to reduce output in response to a possible restriction of the demand. He will therefore be in a better position than the seller, whose stocks are relatively fixed, in negotiating the new prices with the buyers. Elasticity of supply, however, presents a more complicated problem than elasticity of demand, for it is subject, especially in the long run, to a larger variety of forces.

§ 13. Absolute inelasticity of supply is almost, though not quite, as rare as absolute inelasticity of demand. Commodities such as land in a favoured locality or pictures by the old masters cannot be increased in quantity, even though they command enormous prices. But commodities like these are exceptional. Most goods are capable of having the rate of their supply increased or diminished according to the prices that they fetch, and, therefore, in tracing the incidence of taxes we have to bear in mind the possible reactions on the volume of production.

An important factor influencing the elasticity of supply is the mobility or adaptability of the capital goods employed in production. Much machinery and plant is specialised and can be employed in no way except for the original purpose. Other capital instruments can, with certain modifications, be utilised for somewhat different purposes, should occasion require. For example, a machine designed for manufacturing chocolates is of little use in making anything else, but a machine intended for making

parts of watches can be employed, if necessary, for producing delicate parts for other forms of mechanism. If a tax were placed upon the two products, it would appear, assuming the elasticity of demand and other considerations to be the same in each case, that the manufacturer of chocolates would be in a worse position than the manufacturer of watch parts.

The comparative mobility of capital is an important factor in the determination of the incidence of customs duties. Producers in a certain country may have large sums of money invested in highly specialised machinery for supplying a particular foreign market with their goods. The larger is the demand, the greater is the degree to which their specialisation is carried. If, now, the country which imports the products decides to impose a tariff, and if the demand in that country is so elastic that a rise in price by the amount of the duty is likely to cause a serious shrinkage in sales, the sellers may, for a time, have to bear some of the duty themselves. As we shall show later,[1] it is only in rare instances that the foreigner can be made to contribute to the exchequer of the home country, and this is one of them. The producer cannot turn his capital immediately to other purposes, and he has no alternative market of any size for his goods. In such circumstances the incidence of the tariff tends to be partly on the manufacturer.

§ 14. A further consideration in regard to demand and supply may be noted. Some commodities are in joint demand and others are in joint supply. For instance, there is a joint demand for wines and

[1] Pp. 232-237.

bottles, or for pens and ink, and a joint supply of wool and mutton, or of motor tyres and golf balls A tax on one of such articles may, if conditions permit, be shifted in part to the consumer or producer of the other commodity that enters into the joint relation Thus, the wine producer, if he cannot shift all the duty to the consumer, may endeavour to obtain the bottles at a lower price, and thus cause the burden of the tax on wine to fall partly on the maker of bottles The foreign manufacturer of tyres, since he cannot, through the competition of the home manufacturer, raise the price of his goods by the full amount of the tax, may charge more for his golf balls and other rubber products to compensate for the smaller profits on tyres The incidence of the tax on tyres, therefore, is partly on consumers of the other joint products

If, however the manufacturer has already been charging the highest prices consistent with maximum profits, the shifting of the tax on one joint product to the consumers of another joint product will not be so practicable, and the seller will have to consider other means of dealing with the situation It may be assumed that, as a general rule, he has already been charging the best prices for his several types of product But even if he is successful in raising his prices, it may reasonably be argued that, as he could presumably have charged the same prices before the tax was imposed or increased, shifting, in the proper sense of the term, has not taken place Though the tax may have had a considerable effect upon the seller's policy, it cannot be said to have entered directly into price

A similar reservation may be made in regard to the partial shifting of the above-mentioned duty on wine to the manufacturer of the bottles, for here too it may be presumed that the wine producer has already arranged for the supply of bottles at the lowest possible price. If he has, in fact, been paying more than this price, and the tax on the wine now impels him to get lower terms from the bottle manufacturer, the transference of part of the burden is not a straightforward case of shifting as technically understood.

§ 15. A factor of great importance is the time element. Immediately following the imposition of a tax, and particularly if it is of small amount, the manufacturer or seller may be prepared to bear part or all of the tax rather than cause friction with the customer. In the long run, however, the situation may be very different. Supply may be inelastic in a short period but elastic in a long period. At a particular time goods may have accumulated, and, especially if they are perishable, have to be sold for whatever they will fetch. Also, where expensive machinery and other plant have been laid down, it may be impracticable to curtail or postpone production immediately following the imposition of the tax lest the loss on capital should be greater than the amount of the duty. But, over a long period, producers take the tax into their calculation and adjust the supply to the changed circumstances. The investment of new capital becomes restricted. Manufacturers can now raise prices by the full amount of the tax, and face with greater confidence the probable falling-off in

demand, for the warehouses are not now overstocked and the existing plant is not in excess of the demands to be made of it. In the long run, therefore, supply tends to be more elastic than demand, with a corresponding readjustment of incidence.

5. Incidence under Competition

§ 16. The problem of incidence, it will have long been gathered, is intimately bound up with the principles of price determination. To give the subject a proper investigation would necessitate long incursions into the realm of economic theory. Though it is not possible in a few paragraphs to work out and apply the laws of valuation, a brief reference may be made to the main conclusions that bear on the question of incidence.

We have already had occasion to mention the force of competition which, under certain conditions, prevents sellers from shifting a tax to their customers. For convenience we may, to begin with, assume competition still to be the rule. The more effective is the rivalry, the less likely is there to be any difference in the prices charged for similar products. Yet, although there is only a small difference, if any at all, in the selling prices of the goods, there is almost bound to be some variation in the costs of the several firms producing them. One factory may be better equipped or managed than another. Its activities may be on a larger scale, resulting in smaller unit costs. It may be more favourably situated with regard to the source of the materials or to the market for the products.

In short, it could, if circumstances required, sell its goods at a lower price than the one actually ruling at the time. Eventually, perhaps, it may do so, but, so long as it can dispose of the whole of its output at the existing level of prices, there is no point in its pursuing a policy of undercutting. Another firm may be similarly placed, but not quite so advantageously. A third firm just contrives, at the prevailing price, to make ends meet. This firm is said to be on the margin. The unit cost of production of the marginal firm and the selling price of the commodity tend to equality. In the course of time the position of the margin may shift. The first firm may cut its prices, and the second then becomes marginal. Or prices may go up, in which case a new firm, that formerly could not effectively compete, enters the field, and the original marginal firm finds itself advantageously placed in relation to the newcomer. But at any particular time there are likely to be, under competition, a number of firms, each with a different unit cost of production, and each, since the selling price is presumed to be the same, with a varying rate of profit.

§ 17. Suppose, now, that new taxation is imposed. The incidence will vary according to whether the taxes are imposed upon the commodities or upon the profits of the firm. If the tax is placed upon the product, in all probability it will be shifted to the consumer. Should the tax be of small amount, however, the more profitable concerns may decide to bear the amount themselves, in which event the marginal firms may be driven out of existence. As the latter see it, the policy is tantamount to

one of price cutting Similarly, should the demand be so elastic that a serious contraction in sales is feared, the price may be kept at the original figure, with similar consequences for the marginal firms But as a general rule the commodity tax is shifted to the consumers, and the respective positions of the several firms remain unchanged

§ 18 The incidence of a tax on the profits of these concerns, however, tends to work out very differently Since there is invariably a minimum income, free of tax, the marginal firms which make little or no profit are not called upon to pay duty Should the more prosperous firms advance their prices by the equivalent of the tax they are required to pay, they stand the risk of losing some of their custom to the marginal firms, which are under no inducement to raise their prices by a like amount If, as is actually the position, the rate of duty goes up as profits increase, the difficulty of shifting the tax becomes even greater Those who make the largest profits, and, therefore, have to pay the highest rate of tax, are liable to be undercut by those whose profits are just sufficiently smaller to warrant a lower rate of tax These concerns, in their turn, are liable to be undercut by the firms just below them in the scale of profits, and so on The only firms which can transmit the duty without fear of undercutting are those at the margin, and they, as we have already shown, are not called upon to pay any duty Some of the special problems arising out of income tax, especially as affecting the profits of companies, will be noted later We have only attempted to show so far, in very general

terms, how difficult it is to transmit a tax on profits under conditions of competition

6 Incidence under Monopoly

§ 19 It might be urged, however, that free competition is becoming less common, that the advantages of large scale organisation and of centralisation are responsible for a steady movement in the direction of monopoly Once single control over production and selling policy has been secured, there will not, so it might be maintained, be the same impediments to the shifting of taxes as are to be found under competition, the consumer will be at the mercy of the monopolist, and will have to bear the whole of the money burden of the tax

But such conclusions are not quite sound, for the argument ignores the essential differences between the methods of price fixing under competition and monopoly Under competition, as we have mentioned, price tends to approximate to marginal cost Under monopoly there is no necessary identity between cost and price The monopolist can ask as much above the actual cost as he deems practicable The actual price that he decides to charge is determined largely by reference to the conditions of demand He will not ask a very high price if the demand at that figure is likely to be very small He will not ask a very low price if the anticipated increase in the demand is not sufficient to compensate for the reduced profit per unit The price is also determined, in some measure, by reference to the unit costs of production at the different levels

of output As a general rule the unit costs will diminish as the volume of output increases Thus, it may be generalised that the monopolist tends to fix the price at that figure which, having regard to conditions of demand and cost, yield him the greatest net profit , and that the monopoly price is usually at a higher level than would prevail under conditions of competition

§ 20 Consider now a tax either on the mono polised commodity or upon the monopolist's profit If it is placed on the commodity the seller will have to reconsider the whole position The tax may be so small that it is not worth his while to raise the price But if it is appreciable the monopolist, faced with a new set of circumstances, may decide to add the amount, or part of it, to the price of his goods, even though a contraction in his sales and an increase in his unit costs is the result He has not to fear the possibility of being undercut by new rivals, for the commodity tax affects all equally

A tax laid directly on the monopolist's profit, however, would be more difficult to shift He may be tempted to raise his prices, and may perhaps "get away with it" But this would be possible only if he had formerly been charging less than the price which was most advantageous to him If he has already fixed the price at the point of maximum net revenue, he cannot now recoup himself by charg ing more The incidence of such a tax tends to be entirely on the monopolist

In practice it is not so easy to devise such a tax as the simple theory would suggest All mono polists do not work out their prices in the manner

described Some charge less than the theoretical monopoly price, because they do not choose to invite competition Their monopoly may be due to efficient organisation rather than to special legal powers or to exclusive ownership of natural resources, and may continue only so long as prices are kept low Other monopolists have fixed their prices largely by guess work, and are prompted by the new tax to raise their prices and risk the consequences The prices of numerous monopoly products are purely arbitrary (for example, a patented safety razor selling at a guinea), and in these circumstances the incidence of a tax cannot be predicted with any certainty

§ 21 While on the subject of monopoly, it is interesting to note a proposal that illustrates the "socio political" attitude to taxation to which we referred in an earlier chapter Some people would employ the tax as a means of retaliating upon the monopolist If it is true, they argue, that he cannot charge any more than he is already doing, let his share of taxation be increased so that he returns to the public some of his monopoly gains Theoretically the whole of the surplus might appear recoverable in this way Other reformers would favour a different and, in some ways, opposite course of action They begin by showing that it is in the interests of the monopolist to pursue a restrictive policy in the matter of production, that, almost invariably after the elimination of competition, the total output is cut down In order to combat such an anti social tendency, they recommend that the monopolist should be taxed at a *diminishing* rate as his output

increases From such a policy it is expected that, while the incidence would still be on the monopolist, he would not find it to his advantage to restrict the output as he did formerly, or to charge such high prices

While the proposal to single out monopoly profits for special taxation, over and above the ordinary income tax and surtax, has its attractions, it also has its difficulties In particular there is the far from easy task of distinguishing between the true monopoly revenue and the normal "wages of management" The difficulties confronting the second proposal are no less evident Who is to say what should be the total volume of goods produced? We have not, except in the case of the absolute necessaries of life, any real idea of the aggregate amount that should always be available Those commodities, the output of which is seriously restricted by monopoly, do not, for the most part, comprise such vital essentials And, further, there is the difficulty of dealing with the monopolist who, in order to increase his gains, would adopt the policy of reducing the quality as well as the price of his goods If it is desired at all to single out the monopolist for specific treatment, there are more direct ways of doing so than those mentioned

§ 22 The factors governing incidence in general cannot be easily summarised, and an abbreviated statement of the chief conditions is liable to give a false impression of the nature of the problem We shall not attempt, therefore, to reduce the whole subject to a few simple laws, each one of which would require in reality lengthy modification and

qualification It will be sufficient, perhaps, briefly to recapitulate the main conclusions reached in this chapter, as a preliminary to the more detailed analysis of the incidence of particular taxes It was shown, first, that price movements following the imposition or increase of a tax do not necessarily indicate the extent to which it has been shifted Secondly, it was pointed out that the incidence was to some extent influenced by the nature of the tax itself—by its exclusiveness or otherwise, by its magnitude and form, and by its capacity for graduation to the payer's ability Thirdly, the character of the medium selected for taxation was seen to have some bearing on the problem, a tax, for instance, on consumers' goods tended to fall in a different way from one on producers' goods Fourthly, it was noted that the elasticity of demand and supply was a considerable factor in the determination of incidence, in this connection the time element played an important part Finally, the conditions under competition and monopoly were respectively examined, and the incidence was observed to differ according to whether the tax was placed on the products or directly on the competitive profits, a tax on competitive earnings, especially if graduated so as to leave the marginal firm exempt, was not easy to move, but the shifting of a tax on monopoly gains was found to be no less difficult

CHAPTER VI

GENERAL EFFECTS OF TAXATION

1 Reactions on Conditions of Production

§ 1 Having outlined the main forces of incidence, it remains for us to consider in what ways a scheme of taxation as a whole can react on the economic structure and organisation of a country. Subsequently, with the general principles in mind, we shall be in a better position to study and estimate the incidence and effects of particular forms of taxation, and to relate these to each other as parts of the entire fiscal system.

Some aspects of commodity taxation may be noted first. Nowhere is the confusion between incidence and effects more evident than in dealing with the reactions following the imposition of a tax upon a commodity, the cost of production of which alters with the rate of output. Not only does unit cost vary from one firm to another, it also varies for the same firm according to the special conditions governing the production of the article concerned. In these days of large scale organisation everybody is familiar with the principle of diminishing costs, or, differently phrased, the law of increasing returns. The wider is the

market, the greater is the opportunity of installing specialised machinery, of putting into operation an intensive division of labour, and of spreading the overhead charges over a larger amount of product, with the result that the cost per unit is successively diminished.

What is not quite so generally realised is the opposite tendency, known in economic terminology as the law of diminishing returns or increasing unit costs. In the production of crops it does not follow that doubling the outlay of capital and labour on a piece of land will yield more than twice the amount of produce. Perhaps it will yield even less than twice the amount, and after a certain point has been reached it is almost bound to do so. In other words, once the point of maximum yield per unit of outlay has been passed, there is a diminishing return or an increased unit cost. It used to be maintained that the law of diminishing returns was characteristic of agriculture, and that the law of increasing returns operated only in manufacture. But, although examples of the two tendencies are most easily found in these respective divisions of production, the earlier generalisation can readily be shown to be untrue. It is not impossible to obtain increasing returns in the extractive industries, while diminishing returns are by no means unknown in the constructive industries.

§ 2. Suppose that a tax is placed upon a commodity, which is subject to one or other of these laws, and is produced under conditions of competition. If the demand is inelastic the duty will be added to the price, and the volume of production, and therefore the unit costs, will remain unaffected.

At the most there might be a small increase to compensate for the additional charge for capital between the times of advancing the duty to the collector and recovering it from the consumer

Suppose, however, that the demand is so elastic that the rise in price by the amount of the tax leads to a marked contraction in the volume of production If the producer is working under increasing returns, a restriction in output causes his unit costs to rise The profit per article is in consequence diminished, even though the consumer is bearing the whole of the duty The marginal firms find it impossible to carry on, and, though they may sell at a loss for a time, they eventually disappear from the market The supply may thus fall even below the new level of demand, and prices may go up by more than the amount of the tax This likelihood is strengthened by the desire of the producers to make up for the reduction in their profits, due to the falling off in the number of units sold Hence it may be deduced that the price of a taxed commodity, that is produced under increasing returns, and is subject to a sensitive demand, is liable to go up by more than the amount of the tax The full extent of the rise may not, however, take place immediately, and the consumers therefore, when the final addition is made, may not connect it with the imposition of the duty some time before

If, on the other hand, the newly taxed commodity is produced under diminishing returns, the smaller demand is met by a smaller supply at a lower unit cost of production The producer makes a larger profit per unit, so long as the price goes up by the full

amount of the duty, but suffers a reduction in his total sales. Thus there are two conflicting tendencies. The force of competition tends to fix the price at something lower than the level first attained immediately following the imposition of the tax. The drop would correspond to the saving in unit costs. But this tendency is liable to be offset by the desire of the producers to be compensated for their diminished volume of business. On the whole, the chances of the price ultimately settling at a lower level than that first reached are not very strong.

§ 3. From these considerations it is evident that the imposition of a tax upon a commodity produced under increasing returns is liable to inflict serious hurt upon the industry, and, therefore, to violate the principle that a tax should be so designed as to interfere as little as possible with the productive capacity of the nation. This does not, however, imply that the tax should be placed instead upon commodities produced under diminishing returns, particularly if these happen to be foodstuffs. In such cases the possible economy in the costs of production would be more than offset by the hardship to large masses of the population.

Thus, a commodity tax is apt, in more than one way, to react detrimentally upon the wealth-producing abilities of the people. It may restrict the development of an industry that relies for its full development on a wide market and large-scale operations, and may in consequence bring about a less economical disposition of the nation's resources than would result if the tax were absent. It may also, by reducing the purchasing power of the wage-earners,

cause their standard of work to be undermined Of course, where the article is of a purely luxury character, and especially where the restriction of its consumption is likely to have sumptuary effects, the foregoing effects are not so much to be feared There are several commodity duties of this kind, the good points of which more than make up for the bad It is the other class of indirect taxation, which either interferes with the normal growth of an essential industry or curtails the standard of efficiency of the workers, that can be singled out for criticism

2 Savings and Incentive

§ 4 Certain of the above considerations are not applicable to commodity taxes alone If it can be shown that taxation, whether indirect or direct, so reduces the demand for, and therefore the supply of, articles produced under diminishing costs that the economy of the productive system is seriously impaired, there is unquestionably ground for criticism Against the contraction in the taxpayers' demand, however, has to be set the increase in the public expenditure Quantitatively there may appear to be little change in the total volume of demand, though, in other respects, and in the long run, the differences may be considerable

Most types of taxation have this in common that they may encroach upon the national savings A constant supply of new capital is, of course, essential to economic progress, and high taxation can be justly criticised if it can be shown to leave in

sufficient new wealth for replacements and new developments.

That savings, and therefore the supply of fresh capital, have diminished during the last twenty years there can be little doubt. Although we have no proper records of the later decades of the nineteenth century, it is generally agreed that the ratio of savings to total income was greater then than now. It must be admitted, however, that the tradition of saving is not so strong in the twentieth century as it was in the last. Rightly or wrongly, the people of to-day hold a different view of income and expenditure from that held in Victorian times, and, if the standard of saving has diminished, the standard of living has undoubtedly gone up. But even if this change of attitude is ignored, there is no *necessary* connection between the high taxation of the last few years and the comparative shrinkage in the amount of savings. The reduction may be due to the slender surpluses that our taxes leave, or it may be due, among other factors, to the industrial depression and the restriction in the total volume of production. If taxation were lighter, there would naturally be more money available for investment, but that alone does not prove taxation to be the primary cause of the reduced savings.

§ 5. There is the further danger that high taxation may react adversely on the payer's will to save and produce, although on this psychological question there is no un ity of opinion. Taxation will discourage some people from producing, though it may encourage others to work harder than before. One man, especially if he has sufficient laid by to keep

him without working, will argue that high taxation so reduces his income as to impose a penalty, in effect, on further efforts. Another, particularly if he has no other source of income and is loath to cut down his accustomed standard of living, will possibly be induced to exert himself still further, if there is the opportunity, in order to earn the extra money wherewith to pay his taxes. Differences in individual circumstances and natures prevent one from laying down any universal rule.

§ 6. Occasionally, when a tax has been realised to have uneconomic consequences, it has been frankly repealed on that ground. For example, the corporation profits duty was abolished because it was recognised by all parties to have undesirable effects. From the point of view of equity there is much to be said for taxing investment incomes at a higher rate than earned incomes, but there seemed to be no adequate reason for levying upon the ordinary shareholders in joint-stock companies, while exempting the debenture-holders and the possessors of government stock and other gilt-edged securities. This discrimination, apart from the inequity, tended to discourage the investment of capital in those undertakings that contained an element of risk, and to divert it into those channels that provided the greatest safety. The taking of risks, however, is, up to a point, a necessary feature of our economic system, and the penalty imposed on it by the corporation profits duty was, in the opinion of most authorities, detrimental to industrial and commercial enterprise.

§ 7. Although progressive taxation is to be pre-

ferred, as a rule, to proportional taxation, and practically always to regressive taxation, it is possible to find instances in which the application of the method involves a certain economic loss, both to the taxpayer and to the community. Sir Josiah Stamp envisages such a possibility. "For example, £400 a year for a special medical appointment may be very attractive to a medical man with £1000 a year. Another man earning £3000 a year, through extra hard work and ability, may be only just tempted to take it—the marginal utility of money is less to him, but the community is best served by his taking it, as he is the better man. Now, introduce progressive taxation. The £1000 man gets, say, £900 a year, and the appointment is worth £350 to him; the £3000 man gets £2000 net, and the appointment, on taxation, is worth only £200. He exclaims, 'Not worth while for the effort', and the less able man gets it."[1]

Similarly it might be argued that a professional or business man, who is making a large income, may be persuaded to retire from economic activity sooner than he would do if the rates of taxation were lighter. He may aver that, as he is getting on in years and is already assured of a comfortable investment income, the net return after the heavy duties are paid is not sufficient to compensate him for further arduous efforts. If he withdraws on that account from economic activity, while he is still capable of useful production, the community is to some extent the poorer.

§ 8. To sum up, taxation, if it is carried beyond

[1] *Wealth and Taxable Capacity*, p. 116.

a certain point, or if it is not wisely devised and administered, is liable to have damaging effects on the productive powers of the nation. It may bring about a harmful diversion of the country's resources, either directly, through an unwise selection of the media for raising revenue, or indirectly, by checking large-scale production with its attendant economies. It may curtail national savings and the supply of capital, and the consequent increase in the rate of interest may add further to the difficulties of the producer. It may diminish the taxpayer's incentive to work, and curb economic enterprise in general. The actual results will depend, not only on the total amount appropriated for public revenue, but also upon the character and extent of the particular forms of taxation. Our generalisations on the economic aspects of national revenue as a whole may, therefore, give place to a closer examination of the incidence and effects of the principal taxes in our fiscal system.

PART II

THE CHIEF FORMS OF TAXATION

CHAPTER VII

THE INCIDENCE OF THE INCOME TAX

1. The Evolution of the Income Tax

§ 1. The income tax is a modern growth. If one reads the Parliamentary records of a century ago, and some of the vituperative pamphlets that were directed against the projected duty, and then considers the general attitude at the present time, the change in public opinion is almost amazing. Bitter invective and prophecies of ruin have, in the light of experience, been considerably softened. Keen criticism, though it continues, is remarkably mild in comparison with former tirades—notwithstanding the fact that wealthy people nowadays have to pay as many shillings in the pound as it was at first proposed they should pay in pence.

It is instructive to observe the chief stages in the development of income taxation. As noted in a previous chapter, finance ministers have at various times experimented with different tests of ability to pay, but it took several centuries before income was finally selected as the principal criterion. In the earliest days of public revenue the individual was taken as the basis, and every head of population had

to pay a fixed annual amount to the Exchequer At a time when the income of the nation was not very unequally distributed, the poll tax had a certain amount of justification So long as the required amount was not very high, the mass of the people were not severely oppressed, although the nobles escaped with a very light burden in relation to their wealth But, as the poll tax gradually increased, complaints became more numerous and insistent, and a certain graduation, according to social classes, had to be devised Nobles and other prosperous persons were required therefore to pay a higher poll than the people in general Although the modification failed to bring about a satisfactory division of the burden and was very short-lived, it is of interest as being an early (though not the earliest) recognition of the principle of graduation

§ 2 In the course of time the poll taxes were found to be inadequate in their yield and unfair in their incidence Public expenditure was increasing The wealth of the country was becoming more unequally apportioned among the several classes Ministers therefore decided to supplement the taxes per head with taxes on property, and ultimately the new taxes supplanted the old The property basis proved more remunerative, while at the same time, in view of the variations in the amount of property people possessed, it entailed a fairer distribution of the burden

But even in modern times a property tax has been beset with grave difficulties, and it is not surprising that the method proved deficient in the fifteenth century, when the methods of assessment

and collection were extremely crude. Though this mode of taxation survived in some directions—for instance, in local rating in this country—and was later adopted in the form of a general property tax in the United States, it has many drawbacks as a principal means of raising revenue. There is no necessary connection between the ownership of property and ability to pay. Some forms of property are used productively; others yield no return. If the former class is taxed, there is the objection that economic capacity is being interfered with. If the latter class is taxed, there is no certainty that the revenue will be forthcoming.

Further, a tax exclusively on property misses those incomes that are due to personal services. In the first days of property taxation such incomes were comparatively few, but in modern times an ever-growing number of people enjoy large incomes from their own individual efforts. Also, an element of monopoly may exist in their productive powers no less than in the ownership of land or other exclusive property.

Finally, a general property tax is to be criticised because of the difficulties of administration. Tracing the full extent of a person's property is apt to be an inquisitorial and irksome business, while, even when it has been ascertained, there is the troublesome task of estimating its real value, which is liable to alter from one time to another, and, for sentimental and other reasons, may be greater for one person than for another.

§ 3. The most obvious fault, however, that the finance ministers found with the property tax was that it failed to prove a sufficient revenue for public

purposes, and therefore, in the sixteenth and seventeenth centuries, an additional source was tapped in the form of a tax on expenditure. There is considerable force in the contention that a person's expenditure is a good index of his ability to pay. Generally speaking, the more a person spends, the better off he presumably is, and the more he can afford to contribute to the State. It was impracticable, however, to estimate the total amount of the expenditure of each individual, and the only way of reaching him, on a basis of consumption, was to impose duties on certain articles. Hence arose the system of excise duties, which, with certain modifications, has persisted down to the present day. Though the proportion of the State revenues from this source has been declining for a century, and the number of selected commodities has diminished, the actual revenue forthcoming has substantially increased.

Expenditure undoubtedly provides a more universal test of ability than does the possession of property, but it is by no means perfect. As we have pointed out on an earlier occasion,[1] there is no uniform ratio between expenditure and income. The larger is a person's income, the smaller, as a rule, is the proportion devoted to the purchase of taxable objects. Taxation on expenditure, therefore, is open to criticism on the score of being regressive in character. Also, in the case of small incomes, a heavy proportion of expenditure may mean a reduced ability to pay. A person who has to provide for a large family spends more than a bachelor with the same income, but his surplus, on which the tax is

[1] P. 70.

to be imposed, is considerably less. If expenditure taxes could be confined to the comparative comforts and luxuries of life, or if it were possible to assess people on a progressive scale, according to their aggregate individual expenditure, the above objections would lose some of their force, but so long as the prevailing duties are retained criticism will continue.

§ 4. There is still one more stage before we come to the direct taxation of income. Economists and public financiers of the eighteenth century, faced as usual with a constantly growing need for money on the part of the public departments, looked around for a new source of revenue. Property taxes were still in existence, but their drawbacks were by now quite evident. An attempt was made to devise fresh taxation which would retain what good the property taxes possessed, while discarding the undesirable features of the system. It was decided, accordingly, to impose taxes, not so much on the property itself as on the product accruing from the property. Thus the taxpayer would be liable mainly on the annual amount that his property yielded to him. It would no longer be necessary to estimate the capital value of the goods he owned, and to risk all the friction that such a practice involved.

But the drawbacks of such a method soon become obvious. Two pieces of property might yield the same amount of product, but one of them be subject to interest and other charges, while the other be exempt. Or, of two tracts of land yielding the same quantity of produce, the one might be plentifully endowed by nature while the other might require considerable human effort to make good the

disparity. Nor were all the deficiencies of the older property tax removed. People who earned large incomes without the aid of much property in tangible form escaped very lightly. Modern ideas of differentiation and progression could not be incorporated in a scheme of this kind.

The acceptance of the principle, however, that product represents a good test of ability may be regarded as an important step in the evolution of the income tax. What a person produces, and what his property assists in producing, make up between them his total income. The actual methods and machinery of the old tax on product and the modern tax on income are, of course, vastly different, but the respective principles have more in common than might at first be supposed.

§ 5. Developments in fiscal practice take a long time to accomplish, and, although the direct taxation of incomes was spoken of for many years before, it was not until the financial exigencies of the Napoleonic War made some additional sources of revenue imperative that an income tax was introduced into this country. The first outstanding measure was the Act of 1798, which provided for a "triple assessment", based upon the expenditure taxes of the previous year. It was an attempt to translate an expenditure tax into terms of income. Incomes under £60 were exempt, incomes between £60 and £200 were subject to an increasing scale from one one-hundred-and-twentieth to one-tenth, while incomes over £200 paid one-tenth. The revenue, however, did not come up to expectations and the government within the year were induced to make

resort, for the first time in our history, to a tax calculated on a basis of income and nothing else. The triple assessment according to expenditure had led to much evasion and fraud, and Pitt was compelled to admit that it was no longer practicable "to follow some durable, some apparent and sensible, criterion, by which to apportion the burden". Accordingly, he recommended that "the presumption founded upon the assessed taxes shall be laid aside, and that a general tax shall be imposed upon all the leading branches of income". The view of income taxation that Pitt took was in no way reformist. His aim was simply to raise the necessary revenue, and, as soon as the war was over, to abandon the tax. In 1799 the Bill providing for direct taxation was passed, the scales being almost identical with those of the previous Act. Abatements were allowed for children, and also for insurance premiums. A great deal of the administrative machinery then created, such as the General Commissioners, who were appointed by the Land Tax Commissioners, remains to this day.

The new tax proved very unpopular, and in 1802, when hostilities appeared to be over, it was abolished. The resumption of the war in 1803, however, caused a return to be made to the income tax, still on the understanding that it was an emergency measure, to be withdrawn at the earliest opportunity. In the Act of that year the method of assessment was changed. Incomes were to be classified in definite schedules, which, with certain alterations, are still in force at the present time. Provision was also made for the stoppage of tax at source. With varia-

tions in the scales and abatements the tax was continued until the end of the war. The government of 1816, having realised the advantages of the new mode of taxation, attempted to retain it in the Budget, but by a small majority the measure was rejected.

§ 6. The repeal of the income tax was followed by much discussion and pamphleteering. Though the tax was dead, interest in the principle was kept very much alive, especially as the commodity duties had to be increased to make up for the shrinkage in revenue. For twenty-five years would-be reformers were putting forward schemes for the return to direct taxation. The opportunity came in the forties. Industry and trade were depressed, and one Budget after another showed a deficit. Peel, though formerly antagonistic to the principle, now determined to return to the income tax as a temporary expedient. In 1842 the law of 1806 was, with certain alterations, re-enacted for a period of three years, and the British revenues gained a much healthier complexion as a result. It was found necessary, however, to extend the period, and when, some time later, the Corn Laws and certain other protective duties were withdrawn, the need for the direct taxes became even more pressing. Although promises were still held out of a repeal of the income tax as soon as times were favourable, acute observers could foresee that the duty had come to stay. Gladstone and Disraeli were both, in later years, inspired by the same hope, but the attraction of such a lucrative source of revenue proved too strong. The income tax became firmly established in the system of public

finance, and, as time went on, people became more concerned with measures for adjusting it scientifically and equitably to ability to pay than with vain measures for its abolition.

§ 7. The two main objects of the reformers were differentiation between earned and investment incomes and progression in the scales of taxation. Accomplishment, however, was slow. A professor in the fifties criticised the notion of differentiation on the ground that "all should pay to the government at the same rate for the security which enables them to enjoy a unit of income during a unit of time". When Labouchere in the eighties broached the subject of progression, a writer in *The Economist* denounced his scheme as "a preposterous and impossible system of finance". It was not until the present century that the two objects were successfully achieved. In 1907 different rates were devised, 9d. and 1s. respectively, for earned and unearned incomes up to £2000 a year. Three years later the moderate degree of progression, implied by the various allowances at the lower end of income, was supplemented by a more direct measure, which, among other things, provided for a super-tax over and above the ordinary standard rate. Since then the principle has become very widely applied, and the revenue from this source has enormously increased.

2. Opposed Views on Income Tax and Prices

§ 8. Economists and business men frequently differ on questions of practical policy, but, more often than not, the variance is chiefly at the surface. Over the

essential principles there is less dispute than is commonly supposed. There are, however, a few outstanding problems on which there is still a certain difference of opinion. One of these problems is the relationship between direct taxation and prices. A common business view is that income tax tends to be transmitted to the consumer in the form of higher prices. The view of the economist is that income tax ordinarily tends to stay where it is first imposed.

The reasoning of many business men, although it leads to one conclusion, does not always follow the same course. Some of the exponents on that side adopt what appears to be an offshoot of the old diffusion theory. The National Union of Manufacturers, for instance, submitted to the Colwyn Committee that "the difference between direct and indirect taxation hardly exists in actual fact", following up this assertion with the still more surprising statement that "the burden becomes automatically distributed by a law of political economy that defies all Acts of Parliament". This "law", however, defies discovery in modern economic science, the exponent of which would not find it a difficult matter to pick holes in and show the futility of argument of this sort.

The Association of British Chambers of Commerce expressed what appeared to be a more reasoned opinion. "Although theoretically income tax is levied on profits, when a trader endeavours to ascertain his costs with a view of fixing prices, he often takes into account, at least indirectly, the amount of income tax he will have to pay, and if the market conditions permit, fixes his prices at such a level as

would yield to him the minimum net income he de- · to obtain or actually needs." But this view, which was shared by many other organisations and individuals, was defective in more than one respect. In what manner, even indirectly, can a trader take into account the amount of tax he may have to pay? What if (as is usually the case) market conditions do not permit? Can he fix the prices at whatever level he himself chooses? And is the determining factor the extent of his desires or his needs? The authors of the statement throw doubt on the theoretical view that income tax is levied on profits, yet adduce no proof to the contrary.

The question whether or not the income tax is shifted to the consumer is of first importance. The chief attraction of the income tax is supposed to be that it can be apportioned in a progressive manner to the taxpayer's ability to pay. It is presumed that the burden falls upon the person who is specifically called upon to pay the tax. If there is any truth in the contention that a large proportion of the income tax is shifted on to other people, the merits of this form of taxation largely disappear. There is no longer any certainty as to who actually contributes to the State. A great deal of the tax that should remain with the comparatively prosperous manufacturers and merchants would, if the argument were sound, be transmitted to the working classes whom it is not intended to tax by such a method. This is believed, in fact, to be the actual position by certain eminent business authorities. The late Lord Melchett, for example, speaking in the Budget debate in 1923, affirmed that "income tax does not fall upon

the rich, it falls upon a great many people who are not rich. It falls upon the working classes also."

§ 9 The economist does not deny the indirect ill effects that an unduly high income tax may inflict on the poorer as well as the richer classes of the country. What he asserts is merely that the tax is not shifted from one person to another in the form of higher prices, that it rests in the great majority of instances with the person who is specifically assessed. Thus, the submission that a high income tax may discourage enterprise or reduce savings or restrict spending power, all of which indirectly affect supply and demand and eventually prices, would not be repudiated, but would be said to constitute another, and in some ways a deeper, problem. For the moment we are concerned with incidence, with the simple and direct relationship between income tax and prices. Subsequently, we shall go on to examine the ultimate reactions on production and consumption to which the tax gives rise. The prices of goods in the long run are unquestionably affected by the degree of income tax, but the changes, as we shall show, do not come about by a straightforward shifting from seller to buyer. The relationship is much more complex.

3 Income Tax on Profits under Competition

§ 10 In the following account we shall trace first the incidence of the income tax under conditions of competition, and then examine the position under conditions of monopoly. Having observed the general tendencies, we shall proceed to consider the circumstance peculiar to retail traders, to wholesale traders,

to manufacturers, and to others who might be inclined, if they had the opportunity, to incorporate their income tax in the selling price of their goods.

The first and most obvious restraining factor under competitive conditions is the possibility of undercutting on the part of those rival firms who may enjoy special advantages or be better situated with regard to the market. A trader who feels tempted to raise his prices in order to compensate for the amount he has paid in tax will possibly be dissuaded by the fear that his competitors will take advantage of the situation. There may, it is true, be a tacit arrangement between the firms to increase their charges, but these conditions could not be described as competitive. The more intense is the rivalry, the less is the likelihood of the burden being transmitted to the consumer.

Not only will the trader look to the action of his rivals: he will also take into consideration the possible action of his customers. It may be that the article that he is selling is one for which the demand is fairly elastic. A rise in the price may cause such a falling-off in the demand that the net profit is less than it was before. Perhaps there are substitutes on the market, to which the consumers will turn if the trader in question increases his charges. In such circumstances also the prices would be kept down.

§ 11. The above arguments, however, do not of themselves carry one very far. For the chief support to the contention that income tax cannot be shifted, reference has to be made to the teachings of economic science on the subject of price determination. We

have already shown[1] that in competitive industry there may be a number of firms, all selling their products at a more or less uniform price, but having a by no means uniform cost of production As competition increases, it becomes more difficult for prices of a particular type of commodity to vary They may change from day to day, but at any given time they tend to be the same for every body Suppose, by way of illustration, that the market price of an article of a certain grade is 10s A few of the firms selling it at this price could, if conditions required, sell it at 9s and still make a sufficient return to compensate for their effort and enterprise Perhaps they have an exceptionally efficient establishment, or enjoy other advantages which result in a low unit cost Other firms, not quite so well situated, could, if necessary, afford to sell it at 9s 3d , others at 9s 6d , and others again at 9s 9d But some of the firms just contrive to carry on at the prevailing price of 10s Their costs (including the minimum return for wages of management) are almost exactly covered by the selling price thus leaving no surplus These concerns are at the margin between profit and loss Economic reasoning shows that the price of a commodity produced and sold under competitive conditions tends at any time to equal the cost of production of the marginal firm[2]

[1] Pp 108 111

[2] In practice all the firms may have varying unit costs each firm tending to adjust its output to the level at which the selling price just covers the cost of the final units Thus there is an intensive as well as an extensive margin It is sufficient for our present purpose however to confine the account to the simpler form of margin

As time goes on, the firms that are making the largest profits may, in order to extend their market and enjoy perhaps even lower costs in consequence, reduce the price of their products. Suppose the new price is 9s. 9d. Unless the firms formerly at the margin can devise means of reducing their unit costs, they will eventually be driven out of existence. The firms with a unit cost of 9s. 9d. now become marginal. Should the price be reduced still further, another margin would be reached. Over a lengthy period the price would become adjusted to the lowest cost of production, but at any given point of time it would approximate to the highest cost then prevailing.

§ 12. Practical investigations have clearly shown, if proof were at all required, that the marginal firm is not a figment of the economics text-books. An instructive memorandum,[1] prepared for the Colwyn Committee by Dr. W. H. Coates, late of the Board of Inland Revenue, gave the results of an inquiry into seven of the principal trade groups, viz. cotton, wool, iron and steel, metals, food, wholesale distribution, and retail distribution. It was shown that in each of these trade groups "a material proportion of the total turnover is being done at a loss or at no profit. . . . The existence of marginal concerns is clearly indicated." Elsewhere in the same memorandum it is stated that "the producer is always endeavouring to keep the final unit within the profit sphere, but in his search for additional business and additional profit he is constantly approaching the marginal line at which no profit will result, and often he will find

[1] Appendix XI to the Report of the Committee on National Debt and Taxation.

himself carried over the line into the region of loss on his marginal units Price is always hovering in the neighbourhood of that line, on which neither profit nor loss is made Price is determined by the cost of the marginal products, the sale of which yields no profit, and may indeed yield a loss "

The bearing of this conclusion on the present discussion is obvious Since producers at the margin make no surplus, or at any rate insufficient profit to warrant the imposition of income tax, and since, further, it is to their unit costs that the price approximates, there is no element in price that can directly be attributed to tax Any attempt on the part of producers above the margin to raise their prices, in order to recoup themselves for the tax they have paid, would be defeated by the competition of the marginal firms Thus a direct tax on profits tends to stay where it is first imposed

§ 13 Other arguments can be adduced in support of the economist's contention For instance, anybody holding the opinion that income tax can be shifted would be confronted with the difficulty that the scale of duty is by no means uniform Even if it were maintained that the marginal firm was a fiction, or at least that its costs had no important bearing on prices, it could not be denied that the least prosperous firms engaged in production would be making such small profits that their income tax would be at the lowest scale They would be in competition, perhaps, with firms that were making immense profits and paying duty at the higher rates A trader who was doing so well that he had to pay surtax as well as income tax would doubt-

less welcome any opportunity of getting rid of the charge, but, if he were so ill-advised as to raise his prices by the equivalent amount of these taxes, he would promptly be undercut by the rival who was making a smaller profit, and therefore liable to the standard rate only. The latter, in turn, should he attempt to shift the burden, would be undercut by the less prosperous seller who had to pay only half the rate; and so on. Thus, supposing it were possible to transmit the income tax to the consumer, it would be at the scale appropriate to the lowest range of profits. Even if we left out of consideration the marginal firms that made no profits, the firms just above this line would possibly be making such small profits that, after the several abatements and allowances had been deducted, no income tax would in fact have to be paid. These firms, in competition with the rest, would be almost as effective in preventing the shifting of the tax as if they were actually at the margin.

§ 14. So far we have made no reference to the part of joint-stock companies in competition and in price determination. The importance of this type of organisation need hardly be explained. In many industries it has become so predominant that such private undertakings as remain are content to follow the companies' lead in the matter of business policy and price-fixing.

The bearing of company organisation on the incidence of the income tax is twofold. In the first place, the directors of a public company are not, as a general rule, under the same inducement on personal grounds to shift the charge as are the owners of

a private business. Also, the very type of the undertaking, and the scope of its activities, may make the directors unwilling to experiment with higher prices. Secondly, we have to note again the importance of the differential rates of income tax. The standard rate is deducted from the dividends at the source. Those shareholders whose total income is very large are required to pay surtax in addition. Those whose incomes are very modest are entitled to a return, in part or in full, of the tax that has been deducted. The owners of a company, therefore, may individually pay anything from nothing to about ten shillings in the pound on the distributed profits. Some of the wealthier shareholders may favour a policy of raising the prices in the hope of making good some of their tax obligations, but the directors are unlikely to adopt a price policy that is prejudicial to the interests of the organisation as a whole. Well-to-do shareholders, who have to pay tax at a very high rate, may have only a small number of shares in a particular company, and those responsible for the conduct of the business cannot be expected, when fixing the prices of their goods, to take into account the income tax liability of such individuals.

4. Income Tax on Profits under Monopoly

§ 15. Under conditions of competition, then, it is very difficult for producers, whether in a private or corporate capacity, to transmit the income tax to their customers. Would it be more practicable for the seller to shift the burden under conditions of monopoly? On first thought it might appear that,

as the monopolist has a greater control over output and prices than the competitive producer, he would be in a better position to get rid of the charge. Actually, however, as indicated in Chapter V, income tax on monopoly profits tends to remain where first levied.

Complete monopolies are very rarely encountered, and it sometimes happens that a firm holds control over the market only so long as it charges a moderate price. To increase its price might revive competition or encourage the use of substitutes. The income tax on the profits of such a firm would be very difficult to shift. Suppose, however, that the business had a complete monopoly of the goods it sold, and that it could charge whatever price it liked. The limit to the price under such conditions would be imposed chiefly by the nature of the demand. If the article were very necessary, and the demand inelastic, the price would be fixed at a high level. If, on the other hand, the demand were fairly elastic, the price would have to be much lower. The monopolist would try to ascertain the price which, having regard to the possibly varying unit cost of production and to the extent of the demand, yields to him the greatest net profit. To charge more or less than this figure would result in a smaller return.

§ 16. Under competitive conditions, as we have shown, the price approximates in the long run to the cost of production. Under monopoly, as a rule, the price is mainly determined by reference to conditions of demand, and the minimum limit set by cost is but rarely approached. The fact to be emphasised, from our present point of view, is that

the monopoly price is fixed independently of the rate of income tax. The monopolist aims at the highest profit on his sales, and the scale of income tax can have no place in his calculations. It would be different, of course, if the tax were placed on the articles offered for sale. Such a tax would be much easier to shift, but it raises problems that are not pertinent to the problem immediately under consideration. The theoretical conclusion is that a tax on the profits of monopoly, as distinct from the objects sold under monopoly, cannot be shifted, since the seller is presumably already charging the highest prices that the conditions of the market will permit.

In practice, however, the presumption that the monopolist, or, for that matter, the competitive trader, determines upon the most advantageous price is not always borne out by the facts. Owing to ignorance, or inertia, or some other reason, a seller may be charging a lower price than that which the consumers, if put to the test, would bear. An increase in the income tax might prompt him to reconsider the position, and to raise his charges to the most profitable level. Although, in such circumstances, it might be maintained that the additional income tax has been shifted, such an inference would not be justified. The trader could have charged the new price, whether the income tax had been high or low. Though the increase in the duty acted as the motive, the stimulus might have been applied, no less effectively, from other quarters. A creditor, for example, who was pressing for the settlement of a debt might indirectly have been the means of inducing the seller to charge a more advantageous

price Extravagance in the trader's household might have had a similar result The fact that an increased income tax has spurred on a seller to explore the possibilities of a market more thoroughly and to raise his prices in consequence, is no proof that the tax has directly entered into the price

5 Income Tax on Wages and Salaries

§ 17 It is sometimes submitted that the income tax falling on wages and salaries tends to be included in costs of production and thus to be shifted to the consumer But this submission rests on the belief that the recipients have no "surplus" on which the tax can be imposed If every worker were liable to direct taxation, over and above the indirect taxes he already paid, there would doubtless be many who could not possibly bear the charge themselves, with out some loss in physical power and therefore in efficiency, and under these conditions the burden would be shifted from the workers to the employers, and from the employers to the consumers In reality, however, the abatements and allowances are sufficient to exempt the vast majority of the wage-earners from the income tax, and in their case, therefore, the question of shifting does not arise As for those wage and salary receivers, whose incomes are above the exemption limits, there appears no reason for believing that their income tax can figure in costs of production and result in higher prices In so far as their earnings are governed by a cost of living index number, increases in commodity taxation will raise their money wages, and thereby swell

the costs of production. But there is no such avenue available for direct taxation, the burden of which remains at the point of impact.

Suppose, however, that the employer undertakes to pay the income tax of those working for him. Can he include this outlay in his costs, and shift the charge to his customers? If competition is the rule, and if the generous employer's example is not followed by others throughout the industry, it is evident that he cannot transmit the amount of the tax, for any attempt to raise his prices would be to play into his rivals' hands. It might seem that monopoly conditions would have to prevail before the income tax paid on behalf of employees could be shifted to the consumers. But even under these conditions there is no proof that the burden would be made good by charging higher prices. As we have pointed out above, the monopolist does not primarily fix his prices by reference to his cost of production. To advance his charges because of a slight increase in his labour costs might prove a very unwise step.

§ 18. Banking is the only important industry in which the employers make themselves responsible for the income tax of their employees. All the important banks have adopted this practice, and therefore the fear of competition and undercutting on this account does not arise. It is reasonable, however, to assume that, if the banks did not provide these benefits, the actual salaries would be proportionately larger. The payments by the employers on account of income tax are comparable to bonuses and other forms of indirect remuneration. From

the standpoint of the outsider there is no material distinction between them. If the ratio of labour costs in banking were larger than it is, and if the scales of income tax were enormously increased, the directors doubtless would reconsider the situation. But, if they decided upon a new policy, they would be more likely to cut the basic salary rates than increase the charges to their customers. So far, at any rate, there is nothing to warrant the belief that bank charges are any higher than they would be if the employees did not have their income tax paid for them.

6. Qualifying Conditions

§ 19. We have shown that, as a result of the economic forces governing values, and of the differential rates of taxation on profits, it is very difficult for sellers to include the income tax in their calculation of costs and to pass on the charge to their customers. Whether competition or monopoly is prevalent, the likelihood for the tax to remain where imposed is very strong. To this general rule, however, there are certain exceptions which, while not sufficient to necessitate any serious modification in the previous conclusions, are important enough to justify special consideration.

One set of circumstances that might favour a transmission of the income-tax charge is that experienced in a "seller's market", when, because of a marked restriction in supply or a sudden increase in demand, prices show a distinct upward tendency. Our previous reasoning was based on the assumption that, under competitive conditions, the marginal

firm, since it was exempt from income tax, would be quick to seize the opportunity if any of the more profitable concerns attempted to raise their prices by the equivalent of their income tax. By keeping prices down it would stand, in such circumstances, to extend its sales at the expense of its rivals. But if the prices are quickly increasing throughout the market, the temptation for the marginal firm to undersell its rivals is not so evident. The demand may be sufficient to absorb all the supply, even at a higher level of charges. Taking advantage of the situation, the marginal firm may increase its prices along with the rest, and dispose of the whole of its stocks at the higher figures. Thus it might appear that the income tax, in such favourable circumstances, is shifted from the seller to the buyer. But these conditions could not continue for long. Either the demand would soon relax or new producers, hitherto sub-marginal, would enter the field, and, with the consequent change in the proportion between supply and demand, prices would be likely to fall to about their former level. It might be maintained, however, that even in this short period the income tax has not, in the strict sense, directly entered into prices. Where conditions such as the above arise, sellers in general, including those at the margin, are induced to raise their prices, quite independently of the state of the income tax. The tax may be given as the deciding reason for the higher charges, but it is in reality nothing more than an excuse. Usually the prices will be raised, where practicable, without any reference to the income tax at all.

§ 20. The psychological factor at such times cannot be overlooked. An increase in the income tax may cause manufacturers and traders to proclaim to the world at large the inevitability of a consequent rise in prices, and their protestations may so react on the mind of their customers as to weaken what resistance might otherwise be offered to an advance in prices. It is conceivable, further, that sellers who advertise the necessity of raising prices become themselves the victims of the same idea, for they are buyers as well as sellers, and the dealers from whom they make their purchases will be no less willing to take advantage of the situation.

Couple these conditions with those of a "seller's market" and the tendency for prices to advance is accentuated. It might well seem that the burden of the income tax is being shifted from the producer to the consumer. But a double caution is necessary. In so far as the producer has to pay more for his own requirements, both in his business and in his home, the benefit of the better prices for the goods he sells is discounted. Secondly, it must be realised that, so long as a customer's money income remains unchanged, the more he has to pay for some articles, the less there is left wherewith to buy others. An increase in the price of the articles in fairly constant demand may thus involve a fall in the price of the commodities that are not so urgently required.

§ 21. It may happen, of course, that a trader is induced by the income tax to increase his prices, notwithstanding the fact that the higher charges result in a smaller demand and a reduced net profit. The most remunerative price is not always easy to

ascertain, and the trader may in his ignorance go on charging more than this figure, in the belief that he is transmitting the burden to his customers. Ultimately, it is true, competition may bring down the prices to the normal, but for some time sellers may continue to charge more than the most advantageous price. Where monopoly prevails, this check is absent, and the prices may remain for a considerable period above the most remunerative level. Under these conditions the income tax might be said to be a factor in the fixing of prices, although it would still be sound to maintain that the same prices might be charged irrespective of the presence or the rate of tax.

§ 22. The ability to pass on part of the tax burden, where it is experienced at all, is found mainly in retail trade, especially where this is of a luxury character. Where the goods offered for sale vary in grade and quality, the customers are not always able to judge what is the most advantageous price to themselves. In the case of luxury goods, the purchasers are often sufficiently well off to regard small variations in price with comparative indifference, or, at any rate, not to carry their resentment so far as to cut down their orders. Though it is true, as a rule, that the demand for luxury goods is elastic, the demand for very costly articles, bought only by the well-to-do, may be fairly inelastic. In such circumstances the trader, following an increase in his income tax, may raise his prices, yet not suffer an appreciable reduction in his sales.

It has been emphasised that, even where a seller enjoys a monopoly, he is not on that account

enabled to shift the burden of the tax. Where he has already been charging as much as the nature of the demand allows, increased taxation of his profits cannot be reflected in higher charges. But, as we have pointed out, the monopolist does not always charge the utmost he can get, for the reason either that he does not want to provoke latent competition or simply that he is unaware of the most remunerative price to charge. Similarly there are many traders in a semi-monopolistic position who enjoy certain advantages that make for greater profits. They may, for example, be the only dealers of their kind in a particular locality, and, if the goods they sell are such that personal inspection is desirable before purchase, a degree of monopoly may thereby arise. There are several businesses that depend for their success on personal contact between seller and buyer. It is just possible that such traders will contrive to pass on some of the income tax to their customers, though the chances are on the whole very slight.

§ 23. If the retailer finds it very difficult to pass on the income tax, the wholesaler and maker find it almost impossible. The hindrances we have mentioned apply, in one form or another, to all sellers, but there are, in addition, special obstacles confronting merchants and manufacturers. Price movements are much more sensitive than in retail trade. Buying and selling are keener, and the firm that endeavoured to raise its prices because of the income tax would soon find itself undercut by its rivals. Also, since company organisation is more prevalent in wholesale trade and manufacture than in retail

trade, the inducement for shifting the income tax is not, for reasons previously explained, so strong Foreign competition, too, is liable to be more severe than in retail selling, thus adding to the difficulties of the seller who is thinking of recouping himself by higher prices Finally, the customers are shrewder, as a rule, than those of the retail trader Expert and specialised buyers scour the whole range of the market in order to secure the best bargains The general public, on the contrary, who constitute the retailers' customers, are not so well informed, and are less likely to go beyond the immediate locality for their requirements

The assertion is sometimes made that the income tax on the profits of firms in the early stages of the production of an article is passed on to the purchasers at the next stage, and that they in turn transmit the burden, with something added, to the next customers, until eventually the final consumer is required to pay an inflated price for the goods This view, it should now be evident, is fallacious If the tax were imposed upon the materials or the instruments of production, the burden would almost invariably be shifted again and again until it fell with cumulative weight upon the ultimate purchaser But a tax on profits is not open to the same criticism as one on raw materials or semi manufactured goods There is no question of the income tax accumulating from one stage to another If, for some reason or another, a seller at one point did contrive to shift the tax to his customer, the latter would not on that account be enabled to transmit it further At every stage the price approximates to the marginal cost,

in which there is no element to allow for tax The burden, even though it might on occasion be shifted from one producer to another, tends to stay where imposed, and the final selling price remains as a rule unaffected

CHAPTER VIII

THE EFFECTS OF THE INCOME TAX

1. Conditions of Demand and Supply

§ 1. If the income tax affects prices at all, it does so in either of two ways. It is either shifted directly by the producer or trader to his customers, by the simple addition of the equivalent of the tax to the basic price, or it reacts upon prices in an indirect fashion by affecting conditions of demand and supply. Until now we have been entirely concerned with the first of these possibilities, and the argument has shown that it is in only exceptional circumstances that the money burden of the income tax can be directly transmitted from the seller to the buyer in the form of higher prices. Although these circumstances cannot be altogether ignored, they do not materially affect the main conclusions on the theory of incidence that are reached by ordinary economic reasoning. The theory, to recapitulate briefly, is that the price of a commodity tends, under conditions of competition, to equal the unit cost of production of the marginal firm. This firm, being on the borderline between profit and loss, is not required to pay income tax, and is liable, therefore, to undersell

any other firm which attempts to shift the tax on its profits to its customers. Under conditions of monopoly the transmission of the tax is no more practicable, for it is presumed that, as a general rule, the seller is already exploiting his advantage to the full and charging the utmost that the market will bear. This, in a few words, is the view of the economist, as opposed to the notion sometimes encountered that the income tax can readily be shifted.

On the deeper problem, however, of the ultimate relationship of income tax to the demand for and supply of commodities, and the consequent reaction on prices, there is not the same marked difference of opinion. This is not to imply that the economist fully endorses the contention that high taxation—the income tax in particular—is chiefly responsible for movements in prices. More often than not, high taxation is found to be a symptom and an effect rather than a primary cause of industrial conditions. Furthermore, income tax can remain high and even increase, as during the past few years, while prices show a considerable decline. In so far, however, as the income tax can be shown to interfere with the course of production and consumption, the economist would be the first to admit its importance as a price-determining factor.

§ 2. In noting the effects of taxation in general on production, we observed that, if the impost were carried beyond a certain point, enterprise might be discouraged and savings be curtailed. A very high income tax is especially likely to have these effects, for it falls directly upon the return to enterprise, while it must, if for physical reasons alone, diminish

to some extent the saving capacity of the individual taxpayer It may also have a psychological effect upon the will to produce and save, though this is naturally very difficult to estimate A diminished incentive to produce is almost bound to be harmful to the welfare of the nation as a whole

These and other possible effects have still to be examined For the moment all that we can say is that, in so far as a high income tax does restrict the will and the capacity to produce, it is liable to bring about a comparative shortage of goods, with a consequent rise in prices Such a rise, we repeat, would be due, not to a straightforward shifting of the tax, but to the changes in economic conditions to which it gave rise Probably a longer time would be taken for the effects to manifest themselves in the new price level than would be required for a direct shifting of the tax, and the lapse of time may in itself be responsible for people's ignorance of the true cause of the higher prices

§ 3 To pass to the reactions on the side of demand, it might appear that the forces tending in the direction of a rise in prices are counteracted by the opposite set of forces tending to bring about a reduction If a high income tax diminishes spending power, there is more likely to be a fall than a rise in prices Actually, however, as we have already pointed out, there is not necessarily any reduction in the volume of demand regarded as a whole Much of the revenue flows back to the taxpayers as interest on their government stocks An appreciable amount is transferred to the beneficiaries of the public services, whose expenditure,

at least for the time being, helps to sustain the total demand Also the enormous purchases of the State itself have to be taken into account The aggregate demand would seem, therefore, to undergo a change, for the time being at any rate, not so much in its volume as in its composition

To enter in any detail upon a discussion of the likely effects on the prices of particular kinds of goods would take us too far from the present subject The reduced purchasing power of the well to do taxpayer might result in a fall in the price of luxury articles Whether the lower prices would be permanent would depend largely upon the conditions governing their costs of production Possibly, when sufficient time had elapsed, the curtailed supplies would result in higher prices than before On the other hand, an increased spending power given to the poorer sections of the people might, for the time, cause the prices of necessaries to go up, although ultimately, if the latter were produced under conditions of diminishing unit cost, and if competition were effective, the prices might fall even below their former level Whether in fact the spending power of these classes showed a net increase as a result of these transferences would depend upon many circumstances, notably the industrial situation and the character of the public expenditure If, for example, the State subsidised the wages of those already in employment by an extension of the social services, the demand for necessaries would in the aggregate go up, and the prices might follow suit If, on the contrary, the money were used largely for maintaining those out of employment, the aggre

gate demand for necessaries might still be below the normal, for, presumably, the spending power given to the unemployed would be less than that of their normal income.

§ 4. From such reasoning and from the few data that are available on the subject, the state of taxation appears to have more bearing upon relative prices than upon the price level in general. In other words, the values of certain classes of commodities may show considerable variations, yet the index numbers of prices as a whole remain fairly steady. This conclusion derives support from economic teaching on the subject of general prices. According to the "quantity theory", as it is usually known, the level of prices varies directly with the *amount of effective money in circulation* and inversely with the amount of goods produced. Under the head of money is included everything that acts as a means of exchange, whether in the form of metal currency, or bank notes, or credit instruments. The velocity of circulation, too, has its place in the calculation. Since the total amount of money represents a demand for goods, an increase in its quantity, unaccompanied by a corresponding increase in the volume of production, tends to reduce the purchasing power of each unit of money, *i.e.* to raise prices. The only other way in which general prices could be increased would be to reduce the volume of trade, the amount of money either remaining constant or not diminishing in the same degree. A necessary condition of an increase in general prices would be this alteration in the ratio of effective money to goods produced.

Those who maintain that a high income tax causes prices as a whole to go up have to reconcile their argument with the above theory which, apart from points of detail that do not now concern us, is fairly well established. There is no necessary and exact relationship between the level of the income tax and the quantity of effective money in circulation. The extra money used by individuals to pay their taxes means simply that there is so much less for them to devote to other purposes. (Indeed it might be argued that, for reasons still to be discussed, a high income tax, by reacting on savings, and on the enterprise and operations of industrialists, reduces their borrowings from the banks; and that the consequently smaller amount of credit instruments in circulation results in lower rather than higher prices.) The only other way, then, in which the income tax can force up general prices is to bring about a reduction in the total volume of supply relative to the demand—a possibility which will be considered below.

2. Income Tax and the Extent of Savings

§ 5. There are several ways in which a high income tax may react detrimentally to the economic interests of the nation. It may restrict the volume of savings, and so interfere with the supplies of capital that are indispensable to continued production. It may, by reducing people's net incomes, lessen the stimulus to economic effort and enterprise. And, further, it may depress the standard of living among the taxpaying classes to such a degree as to

have important consequences both among the payers themselves and the industries that ordinarily cater for their requirements These three sets of results are not, of course, separate and distinct, and none of them can properly be studied to the entire exclusion of the others We cannot, for example, inquire into the relationship between taxation and savings without paying some regard to the bearing on enterprise Nor can the study of enterprise be dissociated from one's ideas of the accustomed standard of living Also, it goes without saying, the question of the effect on purchasing power is but another side of the problem of savings Common to all these considerations is the psychological factor, the influence of which on the economic activities of the taxpayer is of first importance

We may begin with the possible effects on savings because it is on this subject that statistical information is more readily available than on any of the others Yet even here we have no definite knowledge of the amount and character of savings in pre war and post war years (i e when income tax was relatively low and high), and it is possible to obtain only rough estimates for purposes of comparison The pre war annual savings of all kinds are usually calculated to have been between £350 millions and £400 millions The savings during the last few years are estimated on the average to have been about £500 millions (Over 80 per cent of this total is comprised of three items, internal issues for home investment, about £90 millions, internal issues for foreign investment abroad, about £135 millions, and undistributed profits, about £195 millions) When allowance is

made for the diminished value of money since the war and the increase in the population, these figures really represent a decline in real savings, approximating to between £150 and £200 millions in present values But, as the Colwyn Committee point out in referring to these estimates, "it is fair to remember that the comparison is between unlike periods, the immediate pre war period having been one of booming trade in contrast to the recent years of depression" The fact that the income tax is high at the time that savings are low must not be taken to prove that the one is necessarily the reason for the other They may both be the result of ulterior causes [1]

[1] On the general relationship between spending and savings during recent times, the Committee conclude

'We do not think there are any reliable data for a comparison of spending now and before the war Many people have formed the opinion from their own observation that extravagance and luxury have increased, but this may merely mean that pleasure spending has become more socially obtrusive than before, without having necessarily grown in amount Thus, it may be that there is more lavish expenditure in restaurants, dancing, etc, but that this is more or less balanced by reduced expenditure at home, some confirmation may be found for this idea in the decreased number of domestic servants—1 149,000 in 1921 as compared with 1,314 000 in 1911

Generally we conclude that the falling off in the national savings equal to £150 millions or £200 millions at present-day prices, gives ground for anxiety but not for pessimism It would be unreasonable to expect that in a period of severe trade depression due to deep and world wide causes, there should be an abundant flow of savings It is not clear from the general trend of the evidence before us that the diminished flow has been inadequate to meet current trade demands When those demands increase, we do not doubt that savings will answer to the stimulus, but the need for capital may be very great, and it would be unwise to assume that there will be no shortage' (Colwyn Report, p 22)

§ 6. To what extent is the falling-off in real savings in this country attributable to the income tax? There is obviously a direct relationship in the purely physical sense. The very fact that a taxpayer has to hand over a larger amount to the State than he did formerly, means that, unless his income has kept pace with the increased exactions, he has a smaller balance to devote to expenditure on his personal and business requirements, including the amount to be set aside as savings. It is common knowledge that the percentage of income saved is by no means constant, but that it increases in general at a faster rate than the total income. Conversely, when incomes go down the ratio of savings diminishes in more than proportionate degree. Since the income of the average taxpayer has certainly not kept pace with the income tax, his net remaining income has physically contracted, and therefore the amounts put into savings have almost inevitably declined.

There is a psychological as well as a physical effect, but, on account of conflicting tendencies, one cannot be too certain of the ultimate result. On the one hand, a high income tax may dissuade a taxpayer from saving the customary amount, even though he has the physical ability. After weighing the net future returns against the satisfactions he might derive from present consumption, he may decide in favour of the latter. On the other hand, there are many people whose "demand for income" is not so elastic as the above reasoning assumes. A man may wish to accumulate a certain capital sum during his working life in order to provide an annuity in his declining years; or he may desire sufficient

to protect his dependants in the event of his early demise. Under conditions such as these a high income tax may have the effect of cutting down the current expenditure on consumable goods rather than the amounts set aside as savings. Indeed, if the income were not too small, it might stimulate the recipient to save even more than before, for otherwise continued taxation at the same rate would involve a diminution in the net return in later years. Some writers believe in a stimulus of a different kind, contending that a reduction in the income of prosperous business men is likely to serve as an incentive to further effort and accumulation. Dr. Dalton,[1] for example, quotes with approval the assertion of the late Lord Leverhulme that "every raising of the rate at which income tax is levied has been followed by increased efforts, successfully made, to increase incomes out of which to pay the increased tax. . . . We are all inclined to say, with the Irishman, 'be jabers to the tax, if you will give me the income', and having got the income we are all inclined to make increased efforts to make the income sufficiently large to stand the contribution demanded by the Chancellor of the Exchequer, in the form of income tax, without diminishing the balance remaining for the income earner."[2]

This view of taxation, however, does not appear to command much support in business circles. Lord Leverhulme himself was reported to have stated at an annual meeting of his shareholders in 1923, five years after he made the above utterance, "that any

[1] *Public Finance*, pp. 107-8 (6th edition).

[2] *The Six Hour Day and Other Essays*, p. 248.

relief that can be given to the heavy burden of taxation borne by the citizens of the United Kingdom would have an immediate direct effect in improving business, increasing demand and reducing unemployment". Though this contention is probably concerned more with the effects on enterprise than on savings, it considerably modifies his previous statement. He may have altered his tone because the atmosphere of a shareholders' meeting was different from that of the study. Or the events between 1918 and 1923 may have led him to change his mind on the relationship between taxation and the state of business.

§ 7. The prevailing system of direct taxation undoubtedly differentiates against savings. Income tax is imposed both when the capital sum is first earned and again when the interest from that capital is received. If all forms of outlay (including amounts invested) were hit equally, this differentiation would not arise, but in practice there are many kinds of consumption that are just as important to production, and may endure for just as long a period, as ordinary capital investments from which one expects a specific money return. The "psychic" income derived, for instance, from personal property may be no less important than the money income obtained in dividends, but it is impossible, of course, to render the whole of it liable to taxation. From this point of view the tax as at present administered is not a pure income tax, though it is admittedly difficult to see how such an ideal form of taxation could be devised and carried out.

The differentiation against savings is taken a

stage further by the higher rate that is, in effect, levied upon investment incomes. There are many who are not satisfied by the present scales, and would, if they had the power, differentiate to an even greater extent against the incomes from investment.[1] Evidently they do not fear that the heavier duties would seriously discourage savings; or, if they admit this, they consider that the expected benefits would more than outweigh the disadvantages. Holding the opposite view are those who would not discriminate at all between the scales of duty on earned and investment incomes, while some of them, even more ambitious, would attempt to remove the double taxation now imposed on savings and the income derived. By permitting a partial, if not complete, exemption they would place the capital outlays in a similar category to life insurance premiums. It is partly practical considerations (such as the difficulty of dealing with people who, in order to avoid tax, would save to a great extent in one year, and then dispose of their savings in another) that have prevented a concession of this kind in the past. The trend of economic and political conditions of the last few years, however, does not seem favourable to a move of this kind, but points, if anything, to the continuance of heavy differentiation in the future.

3. Income Tax and the Form of Savings

§ 8. Saving is carried out in a wide variety of ways, and to attempt to trace the effects of the

[1] See, for example, the Minority Report of the Colwyn Committee.

income tax in each of these directions would be a lengthy and complicated task. The available data are very limited, and the results of such an investigation, therefore, would be necessarily inexact. For present purposes we need do no more than consider the reaction on the principal kinds of investors and on the chief forms that their investments take.

The effect of a high income tax on the savings of individuals naturally varies with the amount of the respective incomes. Such savings as come from the lower income ranges are not likely to be seriously curtailed. In the first place, the people in this class benefit to a greater extent than the more prosperous sections by the lower effective rate of duty and by the several abatements and allowances. Secondly, they are more likely to economise in their ordinary expenditure than to cut down their savings, for in these classes the incentive to provide for old age and for dependants is very strong. They are more concerned with making their position secure than with obtaining the maximum immediate return from their wealth. Thirdly, and partly arising out of this, the people in the lower income ranges invest a greater proportion of their capital in house property and insurance policies than the wealthier taxpayers. When taxation is increased the average person in this class is more likely to curtail his everyday expenditure than to cut down his capital outlay in acquiring his house property. The demand for insurance policies, too, is comparatively inelastic, and is helped, doubtless, by the exemption of premium payments from tax.

These expectations are borne out by the official statistics of estate duty. The returns show that in-

surance and house property represent between them about 31 per cent of the total estates not exceeding £5000, but that the proportion falls to less than 18 per cent when all estates, large and small, are taken into account On the other hand the value of securities is about 30 per cent in the smaller estates but nearly 50 per cent in the estates as a whole

§ 9 In the upper grades of income the effect of the tax is more severe As is well known, the bulk of the national savings comes from the comparatively well to do classes, and it is these who contribute the major share of the total revenue of the State The physical capacity to save is naturally reduced, and so to some extent is the will to save It is true that many are prompted by the liability to heavy death duties to put aside large sums for that purpose But others, who are already sufficiently well off to be assured of their dependants' position, may be disinclined to forgo present pleasures Different from the taxpayers in the lower income classes, they look to their investments not merely to give them security but also to enrich them in the near future This explains the high proportion of stocks and shares, as against house property and life insurance, in the wealth accumulations of the prosperous classes The demand for investment of this kind is comparatively elastic as compared with that for house property and insurance, and a steeply progressive scale of duty, which may reduce the net return by anything up to a half, is very liable to restrict the portion of current income that is put aside

§ 10 The attitude of an individual taxpayer to savings is determined largely by the nature of his

economic activity. If he is an employee or a professional worker his policy will be influenced by considerations such as those mentioned above. But if he is a business man working on his own account, or in a private corporate capacity, he will tend to hold a different view of the necessity of saving. He will be influenced, of course, by the personal factors, but in addition he will have to consider the needs of his business. New capital may be required from time to time, and he will find it preferable as a rule to provide the amounts out of the current earnings of the business than to depend on outside financial assistance. Thus, the incentive to save is stronger among business men than among professional and other people with a similar income.

Here again the result depends largely upon the size of the income. In the lower ranges there may be a certain conflict between savings for purely personal and family needs and those which are necessary for business development. The extent to which domestic expenditure will be cut down to provide the required capital varies, of course, with the character of the individual, and it is difficult in consequence to generalise. In the higher income ranges the private business owners are to some extent differentiated against, as compared with public companies, by having to pay surtax on the whole of the profits beyond the statutory amount. On this ground it might be contended that the owner of the prosperous private business is encouraged by the state of the income tax to save no more than is imperative. Where it is not necessary to distribute the whole of the profits, he might equally be induced to contem-

plate the conversion of his business into a limited company.

§ 11. The important part played by companies in the national savings has already been referred to. Roughly two-fifths of the total annual investments of the nation, *i.e.* nearly £200 millions, come from the undistributed profits of corporate undertakings. This is a considerable amount, and testifies to the prudent policy of the companies as a whole. Though the total real savings of the nation have fallen off since the pre-war years, those of the public companies appear to have been fairly well maintained. Investigations undertaken by *The Economist* into the accounts of a large number of representative companies have shown that in the five pre-war years allocations to reserve represented 24·4 per cent of total profit, or 2·3 per cent of capital; and that in the five post-war years the corresponding figures were 24·0 and 2·8 per cent.

The reason lies partly in the fact that the companies virtually compel the shareholders to save, often adding to the reserve funds even though it might involve the passing of a dividend. Were the shareholders to receive the whole of the profits that were earned, it is extremely improbable that they would in the aggregate save as much as that which was withheld from distribution by the directors. And even if they did save as much, the capital would have to be re-collected before it could be put to productive use, whereas, when retained by the company, it would be ready for employment immediately occasion requires.

Such considerations lead to the conclusion that

the adverse effect of the income tax on savings is by no means uniform, and that in regard to particular classes of investors it is apt to be overestimated. The recipients of moderate incomes are less discouraged from saving than the more prosperous classes. The private business owner is, more than the average, liable to diminish his savings, particularly in the upper grades of income. It is some cause for satisfaction, however, to know that the substantial proportion of the national capital that is accumulated by companies has not apparently suffered any material reduction.

§ 12. We turn next to the possible effects of the high income tax on the character and direction of the savings themselves. Reference has already been made to the relatively high proportion of insurance and house property to the savings of the moderate income receivers, and also to the high ratio of stock and share holdings in the accumulations of the well-to-do. There is some difference of opinion on the question whether heavy taxation encourages people to go in for more speculative investments than before, or whether it makes them play for safety by concentrating more on gilt-edged securities. Here again the decision is largely an individual matter, depending also to some extent upon the size of the income. Some authorities have expressed the opinion that, while a high tax is liable to persuade wealthy investors to reduce their holdings of gilt-edged stocks in favour of slightly less safe debentures, it is unlikely to induce them to increase their holdings in risky ventures. If the richer investors are not greatly encouraged to engage in more speculative under-

takings, those in moderate circumstances are even less persuaded, and are, if anything, induced to extend rather than diminish the ratio of gilt edged investments There are, of course, individuals who will go in for more hazardous stocks and shares in the hope of making good the tax exactions, but they are probably in a small minority

The view that the holdings of safe as against speculative investments is tending to increase is supported by the material redistribution of saving power that is resulting from the present rates of taxation The rich are being taxed very heavily, and the proportion of the total savings effected by them is diminishing A relatively larger amount of capital is coming to be invested by those who do not enjoy the largest incomes, and, as we have already pointed out, the lower down in the scale of income we go, the greater is the preference for security But, to repeat, there is no certainty that the high income tax always works out in this way The change in the character of investment is probably due more to the general conditions of industry and trade in the last few years than to the system of taxation, and the above conclusions, therefore, should be used with caution

§ 13 There remains to be noted the possibility of a heavy income tax driving capital abroad From the available records of British investment in foreign countries there are many who not unnaturally infer that home industry is being starved of necessary capital supplies In addition, there is some apprehension that our high taxation is preventing the foreigner from investing in this country

The question, to be properly discussed, would necessitate a comparison of the home and foreign investment markets, and would involve considerations that are far removed from the immediate problem. It is perhaps sufficient here to point out that a person who draws dividends from his foreign investments does not thereby escape liability to the British income tax. Even where the dividends are not actually paid over to him in this country, but are allowed to remain abroad for further investment, the owner is still liable for duty. Further, the investor may be called upon to pay income tax abroad as well as at home, especially now that the number of countries that do not impose direct taxation is rapidly diminishing. The possibility of double taxation tends if anything to discourage foreign investment. The completely effective way of avoiding the home tax on foreign dividends would be for the investor himself to emigrate—a policy that is rarely considered desirable or expedient.

The foreigner, on his part, may be dissuaded by the heavy duties from investing in the United Kingdom, especially when he has to face direct taxation in his own country as well. The net yield that he obtains from most of our gilt-edged securities does not compare very favourably with the rates that he can obtain at home, and thus a certain amount of his investment with us is lost. As against this is the choice open to the foreigner of certain tax-free British Government stocks. On balance the high income tax appears to militate against foreigners investing their money here, although, since the total so invested has never been very large, the loss is not large enough to cause grave concern.

4. Income Tax and Incentive

§ 14. To estimate the reactions of the income tax on the character and extent of the national savings is, as we have seen, a by no means straightforward matter, but the task of weighing up the probable effects on incentive and enterprise is still more difficult. Savings can be measured. It is possible, within broad limits, to ascertain the volume of accumulated capital at different times, and to make a rough conjecture on the influence of taxation on the quantities amassed. We cannot, of course, assume that, if a reduction in savings follows an increase in taxation, the one is the direct cause of the other. Savings during the last fifteen years have diminished for more important reasons than increased taxation. Nevertheless, savings being tangible things, they afford some solid foundation on which the economist can base his reasoning. But economic incentive cannot be so readily reduced to material terms. The psychological factor, important in the discussion of saving, is still more prominent in the consideration of business enterprise, and in the state of our present knowledge it is impossible to calculate with any precision the force of this factor in economic affairs.

It is not surprising, therefore, that the views of different authorities are found to be in opposition. Many writers assert that the present high rates of income tax are distinctly detrimental to adventurous undertakings. Others deny that the scales of taxation have any pronounced effect of this kind, some of them contending that heavy taxation may in

some cases have the reverse effect of stimulating the payer to further effort in order to maintain his accustomed standard of living.[1]

§ 15. The degree in which a high income tax may be prejudicial to enterprise and productive capacity varies to some extent with the character of the income and of the undertaking. Persons whose incomes are fairly regular, whether in the form of dividends on investments or fixed salary for services, have little opportunity of curtailing their production even if they have the inclination. It has to be recognised that the majority of the smaller taxpayers have little chance of adjusting their activities according to the rates of tax, and where they are in a position to do so the benefit they would secure would be very small. Those, on the other hand, who receive their income on a commission basis might be slightly more inclined to slow down their efforts beyond a certain point. Income receivers below the surtax line would not find it of much advantage to adopt a restrictive policy, but those with large incomes might aver that the heavy exactions on the income over £2000 make the additional effort seem hardly worth while. Whether in fact they would reduce their activities is another matter. People often assert that the game is not worth the candle, but nevertheless continue to play it.

The extent to which the income tax weakens the incentive to produce depends not only on the char-

[1] See above, pp. 164-166, where the psychological effects on capital accumulation are referred to. The example there quoted has as much reference to enterprise as to savings.

acter but also on the size of the income. People in the lower income tax ranges are unlikely to let the tax act as a deterrent, first, because the utility of each pound is very high and they are reluctant to lose more than they can help, and secondly, because the rate of progression does not affect them very considerably. It is only among the surtax payers that the heavy deductions are liable to exert a discouraging tendency.

§ 16. So far we have been mainly considering incomes which fall outside the scope of ordinary business profits, and which contain on the average a comparatively small element of reward to enterprise and risk. Business undertakings, which we may now examine more specifically, may be classified into two groups: private concerns and joint-stock companies. The considerations that have been raised in connection with commission and professional earnings may be applied in general to the profits of the private business. The owner of a small business will place a high utility on every pound earned, and will therefore be disinclined to restrict his activities. It is conceivable that he will be stimulated to explore fresh fields in the hope of making good the amount of his tax obligations, for, so long as his undertakings are on a modest scale, his additional net receipts will not render him subject to heavy tax exactions.

The owners of a large private business, however, will be more liable to limit their enterprise, especially in the more speculative branches of their activity. The reward for risk constitutes an important element in most industrial profits, though the percentage

naturally varies according to the character of the business. Where a venture involves the risk of heavy loss, and any gains are certain to be seriously cut down by taxation, the entrepreneur may decide against the particular hazard. An apparent result might be to transfer the function to smaller businesses which, if successful, would not have to pay the same high rates of duty. But the small firms, as a rule, are not in a position to bear risks as effectively as the large firms, and it is more than likely that, if the latter are discouraged from incurring them, they will not be undertaken at all. In so far as the venture was a pure gamble, its rejection might not be a bad thing for the community. But many risks, when carried through, turn out to be to the general advantage. No progress would be made if risky enterprises were altogether debarred. It is possible, therefore, that the steeply graduated scales of taxation, whatever is to be said on other grounds in their favour, have a certain prejudicial effect on venturesome developments.

§ 17. The effects of a high income tax on the enterprise of joint-stock companies are not so serious, for the policy is largely initiated and carried out by directors who are not immediately concerned with the rates of tax that the individual shareholders are required to pay. The scales of surtax in particular have no direct bearing on their policy in apportioning their profits between shareholders and reserve funds. Thus the psychological factor is not such a powerful influence as in the case of the private business, in which the interests of the managers and the owners are more intimately associated.

But the psychological is not the only factor. Heavy taxation, by making inroads on the earnings of a business, is liable to reduce the capital for adequate maintenance and extension. Some businesses cut down the distributed profits rather than encroach on reserves, but others are unwilling or unable to adopt such a policy. This physical influence, on which we have already commented in the discussions on savings, bears on the enterprise of all classes of business, whether privately owned or conducted as a company; for a restricted capital naturally reacts upon the ability and the will to undertake new commitments. Further, the investing public are said to be influenced by high taxation in favour of gilt-edged as against comparatively speculative investments, thus tending to alter the character of industry in general.

§ 18. The above represent the chief arguments of those who claim that the present scales of income tax are inimical to business enterprise and expansion. It remains for us to recount briefly the counter-arguments that are usually put forward. In the first place, it is submitted that the relative falling-off in trade during the last few years is attributable to deeper causes than taxation; that, even if taxes were considerably lower than they are, the damage caused by the war must continue for a long time to have a depressing influence on trade.

Secondly, it is urged that, while taxation dissuades some people from extending their business, it may have the effect of encouraging effort in others. The weight of this argument, we have observed, varies according to the character and the size of

the income, and in any case the net result is very uncertain.

Thirdly, emphasis is laid on the transformation that is taking place in the nature and scale of industrial organisation. New companies are constantly being formed, thus spreading the risk over a wider area than was formerly possible. Business owners often find it expedient at a certain point to convert their concern into a company, thereby unloading much of the risk and responsibility on the general body of shareholders. And further, as we have shown, the enterprise of companies rests largely with directors whose policy may be but remotely influenced by the prevailing rates of taxation.

Finally, it is denied that high taxation differentiates against speculative ventures in favour of gilt-edged investment. It is maintained that, as the income tax hits all kinds of dividend alike, there is no discrimination against revenues from risky enterprises. But this argument does not meet the submission that taxation, by causing a physical reduction in one's *income* and *capital*, occasions a preference for safe over risky stocks. It is not that the existing taxes single out a special kind of investment for differential treatment, but rather that, with a *diminished* capital, an investor is more likely to concentrate on safe securities.

There is much to be said, therefore, both for and against the submission that the income tax is prejudicial to productive enterprise. The problem is one which, for the present, cannot be properly settled, for we do not know sufficient about business psychology to warrant any exact conclusions. It

is reasonable to believe, however, that from the mass of evidence that is gradually accumulating it will eventually be possible to formulate a more definite relationship between taxation and economic incentive

CHAPTER IX

THE INCIDENCE OF THE DEATH DUTIES

1 RELATION OF DEATH DUTIES TO INCOME TAX

§ 1 TAXATION of property passing at death presents many attractions to the fiscal administrator, for it yields a considerable revenue with comparatively little difficulty and expense But it appeals also and with growing force, to those who would use taxation as a means of rectifying our social ills It is a significant fact that many reformers who look to taxation as the means of attaining their ends are now less hopeful than before of obtaining the desired revenue from an increased income tax and are turning their attention to schemes of heavier death duties This is not to say that they admit that the limit of income taxation has been reached, but rather that the death duties have not, in their opinion, been developed to their proper extent in the national scheme of taxation

Death duties are favoured because of the corrective effect they exercise on the institution of inheritance, to which the existing inequality of incomes is largely attributed Progressive taxation of income is one means of rectifying ill distribution,

but alone it is unlikely to effect the desired improvement The only way, it is claimed, in which a really sound scheme of direct taxation can be devised—one which will satisfy the canons of high yield and equity—is to make the death duties on property adequately complementary to the taxes on income

§ 2 The view, however, that the death duties should bear a closer relationship to the income tax is by no means confined to the reformers who regard taxation as an instrument of social amelioration, and who, in particular, would employ the duties to weaken the power of inheritance It is shared by the supporters of the ordinary fiscal doctrine, who are not so much concerned with the ultimate purpose of the tax as with ensuring that it should impose the minimum inconvenience and hardship They recognise that the income tax, as at present devised, has definite limitations, which nothing short of a radical change in the basis of assessment can overcome The death duties, however, can be so administered that some at least of these faults can be remedied, even though one has to wait for a person's death before the defects can be put right

A common criticism of the present method of taxing incomes is that it fails to reach accumulations in a person's wealth, which may not be income in the strict legal sense, but nevertheless represent additions to his possessions A man may, for example, possess some property or some shares, which appreciate considerably in value during his lifetime A fortunate speculation or a gift may work in the same way Though increases in actual income from

the wealth so derived are subject to taxation, this does not altogether meet the case, for the owner may sell his land or stocks at the enhanced value, or dispose of the wealth that has been given to him and spend the proceeds, thus leaving his income for purposes of taxation unchanged. Further, he may have deliberately invested in the first place rather with the idea of capital accretion than with the object of drawing immediate dividends. It is mainly the well-to-do who can afford to adopt this manner of investment. To that extent the income tax, as at present conceived, falls with less weight on such people than on the mass of investors who are chiefly concerned with a quick return.[1]

§ 3. The death duties help to rectify these drawbacks. They do not, it is true, reach accumulations that have been spent or otherwise disposed of during life, but in other directions they serve to balance the burden more equitably among the different kinds of taxpayers. The heir to a large estate might complain of the heavy exactions, but the appropriate answer would be that, had the income tax reached increments in the wealth of the testator, there would have been a smaller capital sum passing at death, so that even with a lower rate of duty the beneficiary would actually be no better off.

[1] If, however, profits on investments were made liable to tax, the question of abatements in respect of losses would certainly arise. In the United States such profits are liable to tax, but losses on investments are permitted to be deducted from taxable income. Thus, following the slump in 1930, the American Treasury lost a considerable revenue, investors finding it to their advantage to realise losses on securities in a falling market, and to make claims accordingly for relief from taxation.

§ 4. In the second place, the death duties make it possible to levy on wealth that yields a "psychic" rather than an actual money income. Though incomes ordinarily take the form of money, or at least can be reduced to such terms for purposes of taxation, there are certain items in most people's aggregate enjoyment which cannot be entered in the tax returns, yet which nevertheless represent true income in the strict sense. A man may invest a sum of money in stocks and shares, or he may spend it on jewellery or other durable form of wealth. Possibly he would reason that the enjoyment he (or more likely his wife) receives from the ownership and display of the gems is equivalent to the money interest that could have been obtained from an ordinary investment. Possibly, too, he would argue that there is a likelihood of the jewels appreciating in value, in which case the investment analogy would be even closer. Yet the immaterial income from these possessions would be immune from taxation. The imposition of death duties, on the passing of this wealth, does not redress this inequality in taxation during lifetime, but at least it prevents it from being perpetuated.

It might be averred that the durable goods have been purchased in the first place out of income on which tax has presumably been paid, and that to impose duty on them at death involves double taxation. This is perfectly true, but it does not on that account invalidate the case for the death duties. For if it is wrong to tax property that has been bought out of previously taxed income, it is equally wrong to tax interest on capital that has at one time or

another sprung from a similar source. On the question whether it is justifiable to differentiate heavily against investment incomes in favour of earned incomes there is much difference of opinion, but few would hold that investment incomes should be exempted from taxation on the ground that the original incomes providing the capital had been made liable to duty.[1]

§ 5. A third way in which the death duties are said to complement, and rectify, the deficiencies of the income tax has relation to the differentiation between earned and investment incomes. Some would defend the impost on estates passing at death simply on the ground that the present allowance in the income tax in favour of earned incomes is in itself insufficient, and that the death duties only capitalise an exaction that otherwise should have been made in periodical instalments during life. In other words, the real differentiation in favour of earned incomes is actually greater than the nominal proportion, but for expediency and other reasons the balance due in effect from the dividend receivers is permitted to accumulate until the estate changes hands, when the account is settled by the payment of a single capital sum.

This reasoning is supported by the further argu-

[1] Possibly the confusion arises from the misuse of the term "double taxation". When used to indicate duplicated imposts on the *same* income by two different taxing authorities, there is much to be said against the practice. But the situation is different when a tax is placed on income, and again at a future time on the dividend from investment originating from that income. "Double taxation" in the latter sense is not so reprehensible as the first kind.

ment that the earned income receiver has usually to put aside a greater sum than the investment holder as provision for himself and family in later years. The dividend receiver is not under the same obligation, for the source of his income is not inherent in himself, but can be transferred when necessary to his dependants. Thus, if A and B have equal money incomes, but that of A comes from his personal services, while that of B is partly or entirely derived from investments, the income that can be devoted to current requirements is less in the case of A than of B. The allowance in favour of earned incomes does to some extent reduce the inequality between them, but it is questionable whether the amount is sufficient to compensate for the greater spending power that B still possesses. Thus the death duties on the estate of the property owner would be held to make up in some degree for the advantage he enjoyed during his life.

Further, it can be shown that the death duties make good the omission of the income tax to differentiate according to the amount of the capital sums invested. Suppose, for example, that in a particular year two investment holders, C and D, receive equal sums in dividends and pay the same amounts in taxation. The former owns shares in a semi-speculative industrial undertaking that yields a profit of 10 per cent. The latter owns twice the value of these shares in government stocks from which he draws 5 per cent. Though they receive the same income and pay the same in taxes, D has actually a much greater capital and tax-paying ability than C. He has no apprehension that his

income may dwindle or even disappear. There is no need for him to set aside anything out of current income to provide against the contingency of loss, although for C this is distinctly advisable. The income of C, though nominally the same as that of D, contains a larger element in respect of risk, and the part of it which he keeps back, if he is wise, is of the nature of an insurance. In a sense, C resembles the earned income receiver in the previous example, who was more obliged to abstain from expenditure than was the fortunate investment holder. Actually, if the three gross incomes are the same, C is better off than the earned income receiver, but D is in turn better off than C. Once again, the death duties are resorted to in order to equalise the burden. The heavier duties on D's estate compensate in some measure for the relatively high income tax that is levied on C.

§ 6. Such considerations give support to the belief that the death duties are a kind of "deferred income tax". Neither of the two principal forms of direct taxation could be adequate in itself, for, no matter how ingenious and far-reaching the assessments might be, they could not be relied upon separately to distribute the burden in a thoroughly equitable manner. Together they remove many discrepancies and close up many loopholes.

It would not be correct, however, to maintain that the two are perfectly complementary in all respects, and that no other correctives are necessary. The checks provided by the death duties to the shortcomings of the income tax are rough and arbitrary, but it is difficult to see how by the nature of things

they could be much different. The element of uncertainty in human existence renders it impossible, even if it were desirable, to make an exact adjustment of capital duties at death to income during life. Even if the estimate is made for a considerable period, during which the length of life may be expected to conform to the average, there are several other factors, not so determinable, that are liable to upset the calculation. Variations in the rate of growth of different estates, changes in the character of the estates between one time and another, fluctuations in the value of property and securities—these are but a few of the factors which must affect the final apportionment of the burden, but which we are not yet in a position to embody in a definite formula.[1]

2. Principles of Graduation

§ 7. Graduation of the death duties presents a more complicated problem than does that of the income tax. Whereas the basis of the latter is comparatively simple and straightforward, duties on estates passing at death may be contrivèd in more than one way. A choice has to be made of several criteria—the value of the estate, the consanguinity of the heir, the size of the individual inheritance, the wealth of the inheritor, and the "age" and composition of the estate itself. The practice varies from one country to another, as do also, largely in consequence, the views on incidence and effects.

[1] See below, pp. 200-203, for a comparison of the economic effects of the income tax and the death duties respectively.

In the United Kingdom the predominant form of death duties is calculated with reference simply to the value of the estate. Though the wealth may go to a son or to somebody distantly, or not at all, related, the same amount of estate duty, on a steeply graduated scale, rising from 1 to 50 per cent, has to be paid. The assumption underlying the estate duty seems to be that the incidence is on the predecessor rather than on the successor, although, as will be shown below, this expectation is not always borne out in practice. Possibly too it is believed that the death duties represent a deferred income tax, in which case the incidence is again assumed to be on the testator.

§ 8. Supplementary to the estate duty in this country are the legacy and succession duties, which impose a charge upon the particular bequests, graduated according to the degree of relationship of the inheritor. Thus 1 per cent is levied on the wealth bequeathed to the wife, husband, child, or lineal descendant or ancestor; 5 per cent in the case of brother or sister, or their lineal descendants; and 10 per cent in the case of other persons. The scale of exemptions being more generous, and of graduation less steep, than that of the estate duty, the revenue is naturally much smaller, averaging in recent years about one-eighth of the yield of the major duty. Nevertheless, the legacy and succession duties afford an important application of the second principle of graduation, and there are many who would like to see their scope extended, even if it meant the scaling-down of the estate duty.

§ 9 These two principles comprise the entire basis of the British scheme of death duties A third principle, however, viz the adjustment of the charge to the size of the individual inheritance, came near to being adopted in the United Kingdom, in the time of Randolph Churchill, as the central pillar of the system The antiquated and cumbersome death duties then in vogue were in need of drastic reform, and it is known that Randolph Churchill did not approve either of taxation of the entire property irrespective of the manner of its apportionment, or of graduation according to consanguinity, which was already provided for in the century old legacy and succession duties It was his intention to scrap the whole of the existing death duties (five in number) and to impose in their place a single levy, graduated according to the extent of particular bequests But political changes prevented him from carrying out his plans, and eight years later, in 1894 Harcourt overhauled the system, introducing the estate duty and retaining the legacy and succession principle The notion, however, is not without its attractions, and is incorporated in the fiscal system of certain foreign countries, such as, for example, France and some American States The difficulties of administration, as against the comparative ease of collection of the other duties, have stood in the way of its adoption in the United Kingdom, though if the principle received greater support the question of practicability should not prove insuperable

§ 10 The above principles, either individually or in some joint relationship, provide the basis of

death duties in practically all the countries in which this mode of taxation is employed. Two further proposals remain to be noted. There is much to be said, from one point of view, in favour of adjusting the tax to the amount of wealth that a legatee already possesses. It may be argued that, since a man who has a larger income than another has to pay a heavier tax on a specific addition to his income, it is just as equitable that the man who already possesses a comparatively large amount of wealth should bear a greater charge on a specific bequest than one who is not so fortunately situated. Some reformers, doubtless, would maintain that a duty of this character would to some extent discourage bequests to people who were already well off, and therefore assist in rectifying the extreme inequality in possessions. The existing death duties, however, must already be having the latter effect, and whether the employment of the fourth principle would make any material difference it is impossible to say. The question of practicability requires serious consideration. To the existing task of computing the testator's property would be added the probably more arduous undertaking of calculating the capital possessions of the heirs. If the wealth were left to a dozen or more beneficiaries, as it often is, it would be no light matter to estimate the duty on each individual bequest. A person's wealth, and therefore his liability, is liable to alter from time to time. A large proportion of his wealth may be in the form of "personal capital", *i.e.* income-earning capacity inherent in his own personal qualities. One man may enjoy a very large income yet possess very little capital in money

and tangible goods. Another may have a moderate income derived from a comparatively large invested capital. If each of them were left an equal sum, it would obviously be unfair to fix the amount of the duty simply by reference to the material goods they respectively possessed. Difficulties like these, though not insuperable, stand in the way of the adoption of such a measure. Failing the ascertainment of the legatee's real capital, it might be possible to regard his income as the criterion, but here again many inequalities and anomalies would be liable to arise.

§ 11. The fifth principle, and one which has received serious attention during the last few years, is that associated with Rignano, though there are several variants of the original proposal. The novel element in such schemes is to differentiate the death duties not so much (if at all) according to the size of the estate, or the relationship or situation of the beneficiary, or the value of the particular bequest, as by reference to the "relative age" of the inheritance itself. At the first time of passing, the duty would be relatively light, but on subsequent transmissions the percentage appropriated by the State would increase. By such means it is hoped that many of the disadvantages of the ordinary death duties, such as the feared discouragement to incentive and thrift, would be avoided, while in the long run the State would draw an even larger revenue from this source and so reduce the inequalities due to inheritance. A scheme which is said to be less detrimental to economic activity, yet results in a greater revenue, naturally attracts attention, and

will be more fully considered in the subsequent chapter [1]

3 The Incidence of the Death Duties

§ 12 To determine the incidence of the death duties appears at first to be an easy matter One might, for example, adopt the simple view that, as dead men pay no taxes, the incidence must be on the successors [2] In reality, however, the position is not so clear or straightforward, for it is a common practice for the testator, during his own lifetime, to make provision for the payment of the duties True, they are not actually paid until he personally is beyond the grasp of earthly tax collectors, but it is equally true that, had the duties not existed, the testator in such cases would not have taken the necessary steps to accumulate and set aside the appropriate amount

§ 13 In this form of taxation, perhaps, more than in any other, has the personal factor to be taken into account If the testator has deliberately cut down his own personal expenditure in order to build up a fund for meeting the taxation at his death, the burden may for practical purposes be regarded as being on him and not on the heir The principle is the same, whether the fund has been acquired by direct savings or by the payment of an annual insurance premium If, however, the economy during the

[1] Still another form of graduation is to adjust the scale of duties according to the number of children in the testator's family Such a method is being experimented with in Italy

[2] Cf Dalton, *Public Finance*, p 53 (6th edition)

testator's lifetime has directly or indirectly affected the income and standard of living of the heir, the burden is to that extent shared by the successor

Similarly, if the predecessor has worked harder, entirely in order to secure the necessary money for payment of the duties, the incidence may be assigned to him alone Had the duties been of smaller amount, the testator would in such circumstances have worked less hard, and the heir would have been no better off Where, on the other hand, the testator does not curtail his personal expenditure, nor increase his productive efforts, the duties are paid in reality at the expense of the successor It is true that the appropriation of duties on the passing of an estate does not, as a rule inflict as much inconvenience upon the inheritor as it would have caused to the prior owner during his lifetime On these grounds the death duties conform better than most other taxes to the canon of convenience

The personal element is paramount in such matters, yet it is, from the standpoint of the onlooker, the most difficult to gauge The extent to which the predecessor makes special provision, by his own sacrifice, for the payment of the duties depends partly upon his individual nature and partly upon the degree of relationship of the heir The closer the consanguinity, the more likely is the real burden of the duty to fall upon the testator The more distant the relationship, the more liable is the incidence to be on the heir Such an apportionment is quite in accordance with the canon of equity

§ 14 The policy of the testator may be influenced also by the prospective amount of the duties Where

the death duties are comparatively small, the predecessor is not so likely to make provision for their payment as he would do if the amount were considerable. Despite the steep graduation of the scales of duty, the burden on the inheritor of a small estate is often relatively greater than that on the inheritor of a large estate, for the testator in the latter case has had a greater incentive to look ahead and make the necessary arrangements.

§ 15. The attitude of the predecessor may further be influenced by the nature of the estate. If the property consists of land or of a business, the testator may be so unwilling to see it broken up that he makes special efforts to accumulate a fund from which the duties can be paid without entrenching upon the main body of the estate. If, on the contrary, the wealth consists of readily saleable and divisible goods, or of stocks and shares, the motive to maintain the estate in an unbroken whole may not be so strong.[1]

§ 16. Incidentally, in so far as the estate duty really falls on the testator, the intentions of those who were responsible for the duty in its present form would seem to be carried out, for the scales are graduated, not on a basis of relationship or individual circumstances of the heir, but simply according to the total value of the estate. It is reasonable to assume that, had the legislators who devised the estate duty desired the main incidence to be on the successor, they would have incorporated in the scheme some

[1] See below, pp. 205-207, where it is shown that in only a small percentage of cases is it necessary to encroach upon the trade assets of a business to obtain the cash sum required for death duties.

measure of graduation according to the degree of consanguinity.

§ 17. The tracing of the incidence of the legacy duty and succession duties, as compared with that of the estate duty, is not such a difficult problem. There is a similar inducement for a man, who contemplates leaving his property to his wife and children, to provide for the minor as well as for the major duties. The fact that only 1 per cent has to be paid when the estate passes in direct line makes it easier for the far-seeing testator to accumulate the additional funds. But where the property, or part of it, is passing out of direct line, the incentive to undertake the burden of the additional duties is not so keen—especially as the duties are 5 per cent of the property going to a brother or sister, and 10 per cent of the share going to other relatives or to friends. As it is from the two higher rates that most of the revenue is obtained, it may be presumed that the incidence of these duties is for the most part on the beneficiaries. Here, too, the tax would seem to fall in accordance with the designs of the legislature.

CHAPTER X

THE EFFECTS OF THE DEATH DUTIES

1. Death Duties and Savings

§ 1. The consideration of the economic effects of the death duties lends itself to a similar line of treatment to that adopted in the discussion of the income tax. First, we may observe the relationship between the duties and the accumulation and supply of capital. Next, we may proceed to the effects, so far as they can be ascertained, on enterprise and the volume of production. Throughout the discussion the psychological as well as the purely physical reactions have to be taken into account.

The common apprehension regarding the effects of the death duties on the supply of capital rests on several grounds. Some of the arguments are perfectly sound, but others are confused and misguided. One view, for instance, that is frequently encountered, is that the death duties eat into the national capital, physically as it were, thus depriving industry of necessary supplies. Great caution is necessary in pursuing this line of argument. Above all it is essential to distinguish between the effects that immediately follow the imposition of the duties and

those which come about when an appreciable time has elapsed. In the short period the death duties do not materially, if at all, reduce the quantity of capital in the country. To the number of heirs to an estate is added another—the Treasury. The actual volume of capital shared out is no less when the death duties are heavy than when they are light. Whether it will remain the same, or, preferably, increase so as to keep pace with normal requirements, depends on certain conditions that can be observed only over a period of time.

§ 2. We frequently encounter the proposal that, since the death duties are supposed to be paid out of a capital fund, the proceeds should be employed as far as possible for capital purposes. To use the money, it is maintained, for current expenditure is to live on national capital, and to suffer in consequence. This contention is apt to mislead, for there need be no physical encroachment on the volume of capital as a whole. It is undeniable, of course, that the estate as such represents a capital amount, and that a certain proportion of this capital is appropriated by the State. If there are not sufficient fluid assets in the estate to pay the duties, part of the capital is sold. The buyer in turn may dispose of some of his capital goods in order to raise the necessary cash, but eventually there must be a buyer who provides the funds out of his own income.

At the time, then, of the payment of the duties, there need be no actual loss of capital to the nation. In the long run, however, an effective reduction in capital may be quite possible. Though the duties themselves are, in reality, paid out of current income,

they may prevent new capital from coming into existence Wealth which ordinarily might have been used in industrial development is diverted to the State The ultimate purchaser referred to above, whose savings out of current income provide the means of settling the duties, does, it is true, acquire a capital investment, and from his point of view there is no material difference between investing his wealth in this way and taking up shares in a new industrial venture But from the standpoint of the nation there may be a considerable difference, for the capital has gone, not to the promotion of a new undertaking, but to replace capital that the State has exacted from an existing concern

§ 3 In some respects the death duties compare favourably with the income tax, in others un favourably In regard to the effect on savings, the death duties exercise a rather more harmful influence The payment of the income tax must to some extent involve some compulsory saving But for the liability to tax, people would spend larger sums in satisfying their own personal needs and whims The income tax may diminish the amount they set aside as savings, but it may also induce them to spend less on non-essentials To the latter extent the possible harmful effect on net savings is rectified The death duties, however, provide no such rectifying influence A person *may* look ahead, and, by setting aside the appropriate amounts during his life, ensure that his heir will receive the estate intact But he is under no obligation to do so, and many wealthy people do not, in fact, make any such provision at all Their scale of expenditure

remains unchecked, and, on their decease, the estates are subjected to heavy exactions. In this negative fashion, therefore, the death duties are apt to be more prejudicial than the income tax to the volume of saving.

Comparison is also invited between the psychological effects of the death duties and those of the income tax on the accumulation of capital. The income tax is with us always; the death duties only at long intervals. The income tax hits us personally; the death duties need not give us such serious concern, even where we are in the position of having any estate to leave behind. In other words, the income tax constantly and at regular intervals obtrudes itself into our personal affairs, and cannot help but influence our economic behaviour. The death duties have not the same immediate bearing on our outlook and policy. We may choose to ignore the exactions on such wealth as may survive us. Or, supposing that we are prepared to make some sacrifice during life in order to provide for the duties, we are on the average so inclined to adopt an over-optimistic view of our life expectations that we frequently put aside a too small annual sum. The practice of insurance may overcome this difficulty, but even then many of us either under-insure against such contingencies, or are apt to delay making the necessary arrangements until it is too late.

Further, there is always the uncertainty of the amount that will be bequeathed. A property owner has a rough idea of the prospective value, but the younger he is, the more likely is his estimate to

depart from the proper amount. His land or buildings may fluctuate in value for reasons he cannot foresee. A *rentier* is in a worse position, for his stocks and shares are liable to greater variations in market values. A business man finds it still more difficult to anticipate the capital value of his worldly wealth at the time of his death, for his accumulation will, as a rule, increase at a faster, yet perhaps more variable, rate than the possessions of the property or share owner. And none of these wealth owners (unless they are well on in years, in which event there is little opportunity for making necessary provision) can predict the scales of duty that are likely to be in force at the date of death. The rates of estate duty have followed a far from uniform course, and it is too soon to assume that stability has been reached.

§ 4. It would appear from the above that the advantage, so far as concerns the incentive to save, lies with the income tax. But, as usual in these discussions, there are several counter-considerations. It will be recalled that the income tax is not so favourable to savings as the foregoing argument seems to suggest; that the heavier rates of tax on investment incomes serve in particular to discourage some people from saving as much as they otherwise would. To that extent the advantage of the income tax has to be discounted. Also, a powerful stimulus in the amassing of wealth is the desire, not so much to leave one's own heirs well provided for, as to raise one's own standard and to enhance one's reputation in a world where wealth is synonymous with distinction. This motive for the accumulation

of riches, which may not be incompatible with the general good, may be too strong to be impaired by a high rate of death duties

2 Death Duties and Production

§ 5 In studying the economic effects of the death duties, regard must be given both to the testator's reactions during his lifetime and to the attitude of the beneficiary before and after the passing of the estate It is a question not only of whether the predecessor is discouraged from saving and working in view of the exactions at his death, but of whether the successor is encouraged to save and work by the knowledge that the bequest is subject to heavy deductions of duty The economic reactions, so far as the heir is concerned, obviously depend on the degree of certainty with which he views the prospective legacy If he is direct line, or closely related, he may be presumed to take the anticipated part of the estate into his calculations, and, in many cases, to save less than he ordinarily would Should he be engaged in business, he may, in more than one way, be influenced in the policy and extent of his undertakings He may be tempted to slacken his efforts He may, on the other hand, be induced to work harder in order to make good the encroachments on the estate Individual temperaments and interests vary so much that it is impossible to generalise on the effects of the death duties on the economic activities of the legatees

If, however, the beneficiary is not closely related to the testator, and the bequest is of the nature of

a windfall, the position is more easily stated. The heir in such circumstances is unlikely to be materially influenced in his business affairs by the possibility of a legacy. Neither his enterprise nor his savings are liable to fall off, and the duties therefore satisfy the conditions of the economist. They also conform to the canon of equity, for few would dispute the justice of imposing a relatively high levy on unexpected increments in wealth. So far, then, as inheritances can be regarded as windfalls, there is much to be said from both points of view in favour of heavy imposts.

§ 6. The economic consequences of the death duties may be viewed in still another light, namely, as affecting the estate itself. Heavy exactions are liable to be detrimental in two ways. First, they may physically reduce the size of the estate, and so restrict its earning capacity. Secondly, even where there are sufficient non-trade assets available to make it unnecessary to encroach upon the revenue-producing part of the estate, the reduction in these fluid supplies may react on the prosperity of the undertaking, limiting enterprise and normal expansion.

Before considering the actual effects, so far as they can be observed, on individual business concerns, we may refer briefly to the common notion that the death duties, as they are at present devised, result over a few generations in the disappearance of large estates. It should be borne in mind, in the first place, that the inheritor, as likely as not, adds something to the estate during his lifetime, thus retarding the downward trend of its amount, as judged over a long period. Secondly, the inter-

vals at which large estates change hands are rather longer than the average, for, as is well known, the longevity of the well-to-do is above the normal. Further, ass ' g that the size of the estate is not added to in any way by successive owners, the scale of duty becomes less and less, thereby postponing for a considerable period the date at which the capital value shrinks to very small proportions.[1]

§ 7. Thus the popular notion, that the present death duties cause a rapid disappearance of large estates, errs on the pessimistic side. Is there more substance in the belief, no less prevalent, that the imposts involve the disintegration of a large number of private businesses at the death of the owner, due to the inability of the executors to find sufficient fluid assets wherewith to meet the claims of the State? If it could be shown that the duties often had this result, there would be ground for weighty criticism. It obviously would not do to retort that a mere change of ownership was involved, and that there was no actual dissipation of capital, for the breaking-up of a business means a distinct loss of

[1] The Report of the Colwyn Committee contains an example of the history of an hypothetical estate of £2,500,000, which first changes hands in 1925. At the first passing 40 per cent is deducted; at the next (on the £1,500,000 that remains) 32 per cent; and so on. On the assumption that duties are levied every 30 years, that the rates remain unchanged, and that in every case the estate passes to a single beneficiary, it is shown that there will still be about £275,000 left at the end of 150 years.

The rates of estate duty, however, have materially increased since the Report was issued, and the capital sum remaining, therefore, would be correspondingly less. On the basis of the scale prevailing in 1930–31 (50 per cent, 42 per cent, etc.), the value of the estate of £2,500,000 would decline in 150 years to slightly below £150,000.

productive power, causing damage not only to the people ˙ ediately concerned but to the nation at large.

In this connection a useful service was rendered a few years ago by the statisticians of the Board of Inland Revenue, who were requested to estimate so far as possible the extent to which the burden of the death duties fell with great severity upon the estates of people engaged in private business. In the words of the Board: "The validity of this criticism of the death duties appears to rest implicitly upon the assumption that men with large private businesses ordinarily invest in them the whole, or by far the greater part, of their fortunes. In other words, it appears to depend on the actual constitution of estates, and, this being so, the Board undertook . . . to attempt a sample analysis of estates which might throw light upon the question."[1]

The results of the lengthy and detailed investigation were very instructive. All the estates with a capital value exceeding £10,000 during the first quarter of 1922 were taken as the basis of inquiry. It was found that, out of 373 estates that came before the Board, 308 estates contained non-trade assets of more than a half of the capital value. And of the remaining 65 estates, only 3 contained insufficient non-trade assets to meet the duty. A stiffer test was applied by regarding all the estate debts as being a charge on the non-trade assets, but even under these severe conditions only 12 estates were found to possess such fluid assets of insufficient amount to settle the duty. Thus, in

[1] Report of Colwyn Committee, Appendix XX.

less than 1 per cent of the estates, under the first test, and in slightly more than 3 per cent under the second, was it really necessary for the capital in the business to be encroached upon The results are not claimed to be thoroughly representative, and it is not denied that in different circumstances and at different periods the burden might be found to fall with greater or less severity They do indicate, however, that there has been a tendency to exaggerate the disintegrating influence of the death duties As the Board remark in their concluding note "It has been necessary in this investigation to draw distinctions between trade and private assets, and in individual cases this hard and fast line may obscure and distort the true facts when viewed as a whole Such defects are unavoidable But making every consideration for abnormalities of this kind, it is suggested that, viewed broadly, the burden of the estate duty does not appear to be a major factor tending towards the disintegration of private businesses"

§ 8 The criticism, then, as applied to the private business, carries little weight As applied to the public company it carries, for obvious reasons, almost none at all Since the majority of the large concerns in the country are organised as public companies, the relative importance of the duties in contributing to the break-up of businesses in general is seen to be very small It is common knowledge that the liability to death duties has been responsible for the conversion of many private businesses into public companies While some authorities are apprehensive about the results of this change, others welcome the reorganisation as being conducive on

the whole, despite the possible loss of the personal element, to greater efficiency and improved service

§ 9 The position of the agricultural estate is admittedly more difficult, in that a landed estate often has a market value in excess of its actual income producing value, the difference often constituting what is termed an "amenity value" For purposes of estate duty the Board of Inland Revenue take the full market value into account It is not unreasonable that, if a landowner invests in part for amenity (or "psychic") income as distinct from money income, the capital value of his property should be calculated on the wider, and not on the narrower, basis Other forms of wealth, from which a psychic income is derived, are included in the estate for purposes of duty, and there appears no adequate reason why land should be treated differently National and sentimental reasons are often put forward for some preferential treatment of agricultural estates These arguments are reinforced by the submission that the landowner, because of the greater calls on his purse, has not the same opportunities as people in business of amassing out of income the necessary funds for the settlement of duty Such considerations, however, are apt to lead us away from the main question We need only express the doubt whether the proper way of meeting the difficulty would be to make any special concessions in the matter of death duties If differential treatment is to be favoured at all, there are other and more direct ways of according it, more logically connected with the exceptional position in which the landowner finds himself

§ 10 Occasionally we find that, owing to a quick succession of deaths in a family, the estate changes hands two or more times in a comparatively short period, and the disintegrating influence of the death duties appears to be very marked in consequence It is necessary to bear in mind, however, that the conjuncture of these deaths may be due to the exceptional longevity of the first of the testators Possibly an abnormally long period has elapsed between his decease and that of his own predecessor Possibly, too, another long period will elapse before the latest owner of the estate will pass from this world Though it is not denied that a quickly repeated succession may involve great difficulties, and may in the peculiar circumstances render necessary a forced sale that would otherwise be avoided, the situation should be viewed in proper perspective over a considerable number of years If this is done, it will be found that the aggregate burden is in reality no greater than the average Indeed, owing to the greater longevity of the richer classes, the frequency of the passing of an estate is likely to be less than the normal

3 The Rignano Scheme of Death Duties

§ 11 " Up to the present, the principle of graduation has been applied to death duties according to two criteria—the size of the estate, and the degree of relationship of the beneficiaries But there is a third criterion which would admit of graduated rates, and this is the *relative age*, if one may name it thus, of the different portions of the estate left by the deceased—or more exactly, the *number of transfers*

in the way of succession and donation which the different portions of the estate have undergone before coming into the possession of the deceased By the application of this criterion of *progression in time*, the right of the testator would vary with the different increments of his estate "[1]

This passage, taken from the translation of Eugenio Rignano's work, contains the gist of his proposal for the reform of the death duties, to which we have previously referred Consideration of his scheme was postponed because we were primarily concerned then with observing the economic consequences of the duties as they are at present devised This is perhaps an opportune occasion for examining the proposals, as the death duties now play a larger part in our finances than ever before, and are likely to assume an even more important place in national politics The scheme was originally conceived, with frankly socialistic motives, for adoption in Italy, but that is no reason why the central principle should not be impartially examined in relation to the fiscal conditions of the United Kingdom There are many authorities in this country, by no means confined to the socialist school of thought, and in several ways opposed to it, who see in the Rignano principle many attractive features, and who would like to see its possibilities carefully explored with a view to an improvement of the British system of taxation Sir Josiah Stamp, for example, states in a judicial introduction to the English version of Rignano's book that "it is not necessary for one to share

[1] E Rignano *The Social Significance of Death Duties* ed by Sir Josiah Stamp pp 37 8

Professor Rignano's (socialistic) ambitions in order to assess the value of his principal idea One may be entirely out of sympathy with his desire to secure progressive socialisation of wealth, and yet look, in the milder application of his principle, for some amelioration of the economic drawbacks of the present taxation system "

§ 12 The basic principle of graduation by distance of time is easily stated, but in the actual schemes submitted for its application there is a considerable variation of method and degree, due to the different viewpoints and intentions of their authors Thus, nothing would satisfy many socialists short of the "maximum project", under which the percentage deducted from an estate would increase at each time of passing until, in the course of two or three generations, the amount of the original estate would be entirely appropriated Indeed this project is not necessarily acceptable to extreme socialists, who regard the rate of disappearance as too slow Rignano himself has received almost as much criticism from socialist quarters as from the defenders of the prevailing order

The "minimum project" is much less ambitious, and for that reason doubtless commands support both among the moderate socialists and among those who, on other questions, have distinctly opposed views Instead of a rising percentage, ultimately reaching 100 per cent, let there be (say) two scales only, one applicable to that portion of the estate that was accumulated by the testator's own efforts and thrift and the other, and heavier, impost applicable to that portion that was previously inherited

Whether the latter portion had been inherited on a former occasion or not, the same scale would apply Between these extremes, various "major" or "minor" projects have been urged, but in their essentials they are on common ground

The redistributional object of these schemes we have already remarked It is becoming so evident to all parties that the institution of inheritance is one of the chief causes of the present inequalities in wealth and income, that people, representing opposed opinion on other subjects, find themselves in substantial agreement on the broad Rignano principle Many, too, support the proposed method of graduation as being less harmful on economic grounds than the existing death duties They would not necessarily favour a scheme that merely added a new duty to those already operating (as contemplated by some in a "minor" project), for that would be more likely to increase than to diminish the uneconomic effects Rather would they reduce the scale of graduation on the first passing of an estate, but make the impost considerably greater on subsequent occasions when the property changed hands

More particularly, however, during the last few years, the proposals have met with support from those who are searching for a more rapid means than we at present possess of extinguishing the national debt We have already pointed out that there is no necessary connection between the revenue obtained from the taxation of estates and capital expenditure such as the reduction of debt Nevertheless, there is something to be said, if for psychological reasons only, for earmarking the yield of such duties

for this particular purpose. A rapid settlement of the debt is desirable, and if for that object a special scheme of death duties on the Rignano plan can be approved of by Parliament, the benefits, it is claimed, are likely to outweigh the drawbacks.

§ 13. Criticisms of the Rignano scheme are put forward on three chief grounds: administrative difficulties, social and personal injustices, and economic defects. On the first we need say little, for there is the authority of the Board of Inland Revenue to the effect that, subject to certain considerations, "it would not be impracticable to introduce in the country an effective scheme of death duty taxation on the lines of the Rignano proposal".[1] It would be necessary for perhaps two generations to elapse before the records would be quite complete and the administration in first-class order. Special provisions would have to be made for dealing with joint investments and with settlements and trusts, while penalties for non-disclosure of gifts *inter vivos* and other possible means of evasion would have to be stiffened. The Board also refer to the costliness of the scheme as compared with the estate duty, which, with all its defects, has at least the merit of comparatively easy and economical collection.

A difficulty to which many critics have drawn attention is that of distinguishing the portion of an estate that had formed part of an earlier bequest, from the portion that had been acquired through the testator's own work and thrift. Physically it might be impracticable to separate them, especially if the previously inherited wealth had been dissi-

[1] Colwyn Report, Appendix XXVI.

pated, and the whole of the estate under review was the result of the testator's subsequent activities In practice it would be impossible, and, most would say, undesirable, to differentiate in such a manner The simplest way of dealing with such an estate would be to divide it into two parts, the one equal in value to that of the previously inherited wealth, and the other equal to the balance The former would be taxed at the higher rate, and the latter at the lower rate

§ 14 On grounds of equity the criticisms of the proposed measure are rather more formidable A simple subtraction of previous from present values, and differential charges on the respective amounts, are liable in certain circumstances, to inflict undue hardship It may happen, for instance, that between the times of the first and the second passing of the estate the purchasing power of money declines to such an extent that, while the money value is the same, the real value is only half what it was originally To impose duties at the higher scale, without taking the changed circumstances into account would entail perhaps a much heavier burden than was originally contemplated (On the other hand, if the purchasing power rose, the imposition of the same duties would involve a lighter burden than could properly be borne) Suppose further, that a man, whose inheritance declined in capital value owing to a rise in general prices, accumulated by his own efforts a capital sum equal to the depreciation in the value of his original estate On his death, the total estate would be identical in money value to the wealth previously inherited, and, if the

Rignano principle were rigidly applied, the higher scale of duty would be imposed on the whole of the estate, notwithstanding the fact that a goodly proportion of it was truly earned. Had the original estate dwindled in value because of the owner's extravagance or business incapacity, there would on practical grounds be some justification for ignoring its particular history. But when an estate depreciates in value entirely because of monetary or other conditions beyond the owner's control, serious inequity is liable to arise from a strict application of the new principle.

This difficulty is to some extent administrative and could be overcome by the use of index numbers. But such measures would not be adequate in those circumstances in which the decline in the capital value of an estate had little or nothing to do with changes in the value of money. A person who is left some stocks or shares in a particular business may experience a fall in their value, possibly, for the sake of argument, to zero. He applies himself assiduously to make good the loss, and at his death leaves a capital amount practically the same as that which he inherited but lost. Obviously a mere adjustment by reference to the index number of general prices would be of no avail in preventing injustice. On the other hand, it is fair to point out that the existing scheme of estate duty is not immune from a similar charge, if not quite to the same degree. An estate that was built up by the testator's own efforts is liable to just as heavy exactions as one which was acquired through inheritance. Nevertheless the force of the criticism cannot be overlooked, and if the

scheme ever came to be applied it would probably be found necessary to make special provision for those cases in which inherited wealth diminished in value as a result of circumstances beyond the owner's control

§ 15 On the question of the probable effects of the proposed Rignano duties on economic incentive and on saving there is a marked difference of opinion The view of the author of the scheme may be expressed first He stresses throughout his work the belief that a person regards wealth which is due to his own efforts "as having a greater value than an equivalent sum which he had inherited" The preference is said to arise from the fact that the produced portion of the estate will be taxed more lightly than the inherited portion "It is this extra value, so to speak, inherent in the wealth accumulated by his own labour and thrift, that would provide the heir with a new incentive to labour and economise, three or four times greater than the present stimulus" The supposed degree of superiority is doubtless exaggerated What really concerns us, however, is whether there is any stimulus at all, for it is one of the stock criticisms of all death duties that they reduce the incentive to work and save, and thus bring about considerable economic loss

It cannot be gainsaid that on this point at least the proposed measure would score over the prevailing method of death duties As things are, there is no discrimination between the different parts of an estate Though some differentiation is allowed in the taxation of "earned" and "unearned" incomes, no such classification is made regarding

capital estates. Yet a certain parallelism can hardly be denied. A lighter tax on "earned" incomes is commonly admitted to be favourable to enterprise. Similarly, a lighter duty on "earned" estates might be shown to be less discouraging to economic activity than an undifferentiated heavier duty. Of course the effects could be proved to be less harmful to enterprise only if the rates of duty under the Rignano scheme on "earned" estates were lighter than the rates now imposed. This should not be impracticable. At the second and subsequent times of passing the ratio could be much increased in order to restore the balance. If the chief object were redistributional or socialistic, the subsequent increase could do more than restore the balance, for it could be contrived so as to result in the appropriation of a larger aggregate share of the estate than is yielded by the existing duties. The ultimate purpose, however, is not now under consideration. If it were true that a comparatively light impost to begin with, followed by a relatively larger tax a generation later, were less detrimental to enterprise and thrift than a scale uniformly imposed on every part of an estate, there would be many supporters of the principle of "progression in time" among people who in other respects are firmly antagonistic to socialistic projects.

Even where a tax has been in force for many years it is no easy matter to weigh up the numerous economic effects both on the taxpayer in particular and on industry in general. As the Rignano scheme, or anything like it, has not been put into operation in any country, its reactions can be only generally surmised.

Those who oppose the Rignano principle on economic, as distinct from other, grounds are apprehensive lest the prospective high duties on an estate that has already been inherited should dissuade the owner from economic effort and incite him to extravagant expenditure This double danger would not be serious where the owner had accumulated, or was capable of accumulating, a stock of wealth over and above the value of the inherited estate, for on that part of his total capital due to his own efforts or abstinence a lower scale of duty would be payable It might, however, be serious in those circumstances, previously mentioned, in which the original estate had shrunk in value, and subsequent accumulations would be regarded, to the extent of that shrinkage, as if they formed part of the original estate, and were therefore subject to the heavier scale of duty

If the "maximum project", or a similar measure were put into force, the liability for the estate to be squandered would be specially marked in the later stages of the history of the estate, particularly if the scheme culminated in a complete appropriation of the balance It is unnecessary to enlarge on the temptations of the owner of the last remnant of an estate that is due at the next passing to become the property of the nation If he has children or other dependants, he may work desperately to leave some thing behind The economic result may be distinctly beneficial If he has no near relatives, or if such as he has are already well provided for, he may purchase a life annuity with his remaining capital or dissipate it in a less desirable way In the latter event there is likely to be economic loss, and in any case the

State loses the revenue when it would ordinarily become due. This is admittedly an extreme example, but it points to a danger that might arise, though in smaller degree, even where the State did not put the "maximum project" into operation.

§ 16 Such possible dangers are realised by many supporters of the general principle, some of whom have put forward modified proposals in the hope that these defects will be avoided. One of the best known of these schemes is that sponsored by Dr Hugh Dalton,[1] who, while strongly in favour of graduation according to the "relative age" of the estate, recognises that under the original Rignano plan there might be some encouragement to extravagant and wasteful expenditure, as well as to increased gifts *inter vivos*. He proposes to check these abuses by mortgaging, as it were, on the passing of an estate an *additional* amount representing the liability at the next passing. Thus, when an estate changed hands, the State would impose death duties in the usual manner, but, over and above the sum so exacted, a supplementary levy would be imposed equal to the amount that was, in effect, earmarked for appropriation at the next change of ownership. In exchange for this capital sum the heir during his life would receive a guaranteed income on a corresponding basis, or, if preferred, an annuity for a fixed number of years. Theoretically, therefore, the heir would be no worse off in regard

[1] Outlined and criticised in the Report of the Committee on National Debt and Taxation, pp 316 18. See also H Clay, *Property and Inheritance* (reprinted in *The Problem of Industrial Relations*), and H D Henderson, *Inheritance and Inequality*.

to income, but on his death the State would be assured of the capital sum. For the period of his life no benefit would accrue to the State, for presumably the guaranteed income or terminable annuity payments would be equivalent to the interest on the capital invested in first-class securities. The advantage, from the point of view of the Treasury, would be the certainty of eventually receiving the capital sum, without any fear of its being dissipated by the heir. A similar procedure would be adopted on each of the subsequent occasions on which the estate changed hands.

Dr. Dalton realises the difficulty, in many cases the impossibility, of paying the double amount in cash, without seriously prejudicing the future earning power of the estate, and he therefore proposes that the supplementary impost might be paid in government or other approved securities. The latter might include stocks and shares and other industrial holdings, which would have to be administered by the Public Trustee or similar official until such time as they became the full property of the State. On the practicability of such a measure serious doubt has naturally arisen, especially as the State might be involved in loss when it came to convert the securities into cash. The view naturally alters with one's individual attitude. If the Rignano-Dalton plan is propounded with socialistic motives, the idea of the State being saddled with all kinds of property occasions no alarm, especially as some of the wealth entrusted to it would consist of land, railway, mine, and other interests which it is the avowed intention of the socialist eventually to

nationalise. As for that part of the capital that was handed over in the form of government stocks, no difficulty need arise, for it could be applied automatically to the reduction of the National Debt.

An advantage that is claimed for the scheme is that it would avoid the hardship and difficulties previously mentioned, due to changes in the value of an estate during the inheritor's lifetime. The liability which, under the original plan, would become due at his death is, under Dr. Dalton's scheme, settled in advance. The burden of any decline in value would fall on the State. (On the other hand, any appreciation in value would go to swell the Treasury.) Thus, such discouragement to enterprise and thrift as might arise under these conditions would disappear. An heir who was unfortunate enough to suffer a reduction in the value of his estate, whether due to monetary or other conditions, need no longer be dissuaded from working and saving by the knowledge that his own accumulations would be taxed at the higher rate as if they had been acquired through inheritance.

§ 17. This variant on the Rignano scheme has, as we should expect, encountered weighty criticism. First, there are the doubts already indicated, regarding the practicability of the State acting as trustee for such a large and heterogeneous collection of interests as the scheme would almost certainly require. Mr. J. M. Keynes has expressed the opinion that the administration of trustee securities is most efficiently carried out, not by a few enormous investment trusts, but by a comparatively large number of smaller trusts, each being respon-

sible for about £10,000,000 of securities From this standpoint the case against State trusteeship would be even stronger

Secondly, apart from the practicability of the scheme, there is the question of its desirability As Professor Henry Clay observes, "Economically one of the most important services that capital renders is the opportunity it gives to its owner to experiment, to take risks, to undertake enterprises that will not bear fruit for a long time The personal interest that an owner takes in his property, where his property is not yet reduced to an abstract right to money payments, is also a loss to be deplored, the upkeep of agricultural land, the care of house property, the intensive supervision of machinery by people of a mechanical turn of mind, the attachment to a family business, are sources of wealth that a departmentalised Public Trustee could hardly supply "[1]

Thirdly, the scheme is objected to on the ground that people would be compelled to participate in a form of investment which is known to be unpopular Quite apart from the loss of their freedom to utilise the wealth in whatever other way suited them, the majority of investors, if experience counts for any thing, would prefer other means of assuring an income They could, of course, if they so wished, dispose of their annuity interests, but buyers would be relatively so few that the capital sum obtained would almost certainly be below the nominal value In this sense, therefore, the burden on the taxpayer might be greater than would at first appear

[1] *Property and Inheritance (The Problem of Industrial Relations*, pp 276 7)

Several other arguments, both for and against, could be enumerated, but sufficient has been said, perhaps, to give a broad idea of the proposals and the difficulties to which they are subject There is no purpose in meticulously analysing the details of a plan when the authors themselves admit that practical realities would probably necessitate many important modifications The schemes are purely tentative and they are put forward more as a basis of discussion than as fully worked out measures for immediate application Though one may approve or disapprove of particular proposals, the central principle of graduation by distance of time has much to commend it, and is worthy of serious considera tion by those who wish to readjust the burden of our present taxes

CHAPTER XI

COMMODITY DUTIES

1 THE RELATION OF DIRECT AND INDIRECT TAXATION

§ 1 OUR discussions so far have been largely confined to the income tax and the death duties, both of which are usually covered by the term direct taxation They are said to be direct because they are imposed specifically on the persons who are intended to bear the charge, although, as we have observed, shifting of these taxes is not unknown Taxes on commodities, on the other hand, are customarily described as indirect, in that the impact and the incidence are on different persons This description, however, is not altogether exact, for there are certain commodity duties that are much more direct than indirect For instance, the customs duties that are imposed on articles brought into the country by the actual consumer are levied upon him directly Similarly, in so far as the conditions of production and of demand compel the manufacturer or dealer to bear part, if not the whole, of the duty himself, the impost is again direct in character In speaking, therefore, of indirect taxes, care should be

taken not to include within their scope every duty that is nominally on a commodity basis

§ 2 Commodity duties are very old, and at one time in the fiscal history of this country provided the bulk of the national revenue But, as we showed in Chapter VII, they proved inadequate to meet the ever growing needs of the public departments, and at the beginning of the nineteenth century the income tax, at first as an emergency war measure, was intro duced to supply the deficiency Though this new tax was repealed on the termination of the Napoleonic War, the precedent had been established, and when later, in 1842, the financial difficulties of the govern ment made a return to the income tax inevitable, the change was effected with less difficulty than would have been experienced had the system been alto gether new Since then the importance of the commodity duties has relatively declined, although in point of actual revenue they have yielded a rapidly growing revenue [1]

Once the income tax had secured a permanent place in the fiscal system, the idea of a balance be tween the two forms of revenue gradually arose, and no less an authority than Gladstone spoke of a de sired parity between income and commodity taxes In an oft quoted passage he said, "I never can think of direct and indirect taxation except as I should think of two attractive sisters who have been intro duced into the gay world of London, each with an ample fortune, both having the same parentage—for

[1] Customs and excise duties yielded £75 millions in 1913–14, and £247 millions in 1929–30—a considerable increase in amount, even with the change in the price level taken into account

the parents of both I believe to be Necessity and Invention—differing only as sisters may differ I cannot conceive any reason why there should be any unfriendly rivalry between the admirers of the two damsels, and I frankly own, whether it be due to a lax sense of moral obligation or not, that as a Chancellor of the Exchequer, if not as a Member of this House, I have always thought it not only allowable but even an act of duty to pay my addresses to them both I am therefore as between direct and indirect taxation perfectly impartial"

The equality that Gladstone desired was not actually achieved until the Great War, although for many years before then the ratios were tending in that direction At the beginning of this century the proportions of direct and indirect taxation were 42 and 58 per cent respectively In the year before the war they were 48 and 52, and in the year following it they had changed to 60 and 40 Since then the proportion of the revenue from the income tax, the death duties, and other direct taxes has considerably exceeded that from the customs and excise duties Thus the position has been roughly reversed, and doubtless there are some at the present time who also, but with a different motive from that of the nineteenth-century radicals, would like to see some degree of equality between the two chief groups of taxes But there is no sanctity in the "fifty fifty" arrangement In order to obtain the necessary funds for carrying on the government of the country there is no special reason why a half should come from one type of duty and a half from another The system of taxation must necessarily be treated as

a whole. The revenue in general should be raised as equitably and economically as possible, with the minimum interference with the productive capacity of the nation. In the att ˙ ent of this object it is of no importance whether the respective ratios are 50-50, or 60-40, or 70-30. The argument for parity may have had some political value at a time when the well-to-do were escaping with much less than their fair share of taxation, but as a statement of a scientific relationship it is entirely worthless.

§ 3. There has been an interesting change-over, not only in the respective proportions of indirect and direct taxation, but also in the attitude shown to commodity duties themselves. In the early days of taxation the nobles and others in a privileged position were largely immune from taxation, and duties on expenditure were proposed as a means of reaching these classes and so securing a more equitable distribution of the financial burden. Now it is the most frequent criticism of these duties that they press with undue severity on the working classes. Whereas the income tax is graduated on a progressive scale according to individual ability to pay, the commodity duties are for the most part at a flat rate, and are distinctly regressive in character. A man with an income ten times that of another pays considerably more than ten times the amount of income tax. But on the basis of expenditure he pays nothing like ten times as much in commodity duties. Even when the taxes on luxury articles are taken into account, the burden is relatively lighter for the wealthy than for the working classes. Further, when the flat rate duty on essentials is examined, it is

observed that the impost is doubly regressive in its burden, for the prices of the cheaper grades increase in a greater ratio than those of the better qualities which the poor cannot afford. A flat-rate duty of (say) 3d. per unit of a commodity costing anything from 1s. to 2s. 6d. entails a burden diminishing from 25 to 10 per cent.[1] The differentiation against the poorer classes was shown in the tables published in the Report of the Colwyn Committee. People with earned incomes of £100 paid 11·9 per cent in indirect taxes (on the basis of the 1925–26 scales, and assuming a family of man, wife, and three children under 16). Those earning £150 paid 11·6 per cent; and on £200 paid 10·2 per cent. When liability to income tax was reached, the balance was not restored, since on an earned income of £500 only 2 per cent was paid in direct taxation, while the proportion of indirect taxation fell to 4·2 per cent. In other terms, as the earned income rose from £100 to £500, the total taxation fell from 11·9 to 6·2 per cent.[2]

2. Commodity Duties in General

(It is hardly practicable in a short work to enter into a separate analysis of the incidence and effects of every individual commodity duty. The chief conditions arising from the taxation of commodities —such as the elasticity of demand, variability of production costs, and so forth—have already been

[1] See above, pp. 96-98, on specific and *ad valorem* duties, and their bearing on incidence.

[2] See Appendix, Tables VII and VIII, for fuller statistics.

examined in Chapters V and VI, and on questions relating to the imposition of particular duties reference may be made to the general analysis therein contained)

§ 4 The comparative weight with which commodity taxation presses on the working classes leads one to consider the possible effects on the standard rates of wages But, though attempts have been made to estimate the degree in which the excise and customs duties have been responsible for an increase in the rates of wages, the results have been vague and disappointing In some industries the movement of wages has lagged behind that of taxation, in others it has gone ahead Even where the worker's income has kept pace, or more than kept pace, with the increase in prices due to taxation, there is nothing to prove that this item in the cost of living was specifically responsible for the wages advance The Colwyn Committee considered the relationship in some detail, and reached the general conclusion that "wage earners, as a whole, have obtained a certain indefinable increase on account of the extra post-war burden of Customs and Excise duties which they bear In wage negotiations the idea of the cost of living has been influential, the increased duties have been an element in the post-war cost, and the Ministry of Labour index, which reflects the increased duties on tea, sugar, and to some extent tobacco, has been an important standard of reference" Later, however, they remark "It cannot be said that wage earners as a whole have any definite part—or, it seems, any very considerable part—of the extra burden laid upon them".

§ 5. It has to be remembered that several of the commodity taxes are voluntary in nature. Nobody is compelled to pay the duty on tobacco or alcoholic drinks unless he chooses to consume such articles. It is not as if they were necessaries of life, which could not be omitted from one's budget without detriment to health or efficiency. It is true of course that many consumers are not aware of the full extent of their tax payments, and that some of them would curtail their expenditure on dutiable objects if they had more knowledge of the exact composition of the inclusive prices charged. But this ignorance is not so prevalent as it used to be, and if people continue to pay the "voluntary" taxes on comparative luxuries with their eyes open, the regressive nature of the duties becomes less reprehensible.

Also, it should be borne in mind that the duties on alcoholic beverages, and in a minor degree on tobacco, may have a certain sumptuary effect. Even where the commodity is not physically harmful, the diversion of expenditure to more useful purposes may result in a net advantage. The view that taxation should be expressly designed for curbing noxious or other undesirable consumption is not free from criticism, for, if it is deemed necessary to check the consumption of a commodity, there are more direct and effective ways of achieving that end. But, when a duty serves the double purpose of restricting such forms of consumption, and at the same time yielding a large revenue, there are few, apart from the consumers themselves, who would favour a heavy reduction in the rate.

§ 6. Other possible economic effects of commodity duties in general call for little mention. The adverse effects on savings are comparatively unimportant, particularly as the bulk of the national savings comes from people whose contributions in these taxes work out at a very small percentage of their incomes. The ill-effects on enterprise are practically negligible, for much the same reason. More serious is their liability to interfere with the most advantageous arrangement of economic resources. Should a tax be so badly conceived as to fall on a raw material or on a partly manufactured commodity that is used in further production, the charge is liable to be passed on in snowball fashion, causing the ultimate consumer to part with a much larger additional amount than goes in revenue to the State. Manufacturers and dealers have to lay out larger sums than would otherwise be necessary, and the flow of capital into those channels where it would be most economically employed is thereby impeded.

§ 7. While recognising these serious drawbacks of commodity duties, and the force of the argument for their reduction so far as they cause a harmful diversion of expenditure, or press with unfair severity on the very poor, we should not ignore the weighty arguments that are adduced in their favour. They are a very lucrative source of revenue, and are collected fairly easily and conveniently. Also, they afford a means of reaching those classes which, mainly because of administrative difficulties, are not made liable to the more direct forms of taxation. To this is often added the political argument

that nobody should be entirely exempted from tax obligations, and that the duties on commodities used in all households provide the only opportunity of bringing everybody into the net. As we are concerned with the economics rather than with the politics of indirect taxation, it is unnecessary for us to examine this argument at any length. Yet if its practical significance were examined it would probably be found that the connection between taxation and political rights is more of theoretical than of real application at the present time. If everyone in the State had a decent minimum standard of life, there would perhaps be some force in the submission. But when a large number of people have hardly enough to provide bare subsistence, it would be impracticable to apply the principle with any rigidity.

3. Customs Duties

§ 8. The conditions governing the incidence of customs duties are in many respects identical with those affecting the apportionment of excise duties, and to consider them all would involve us in needless repetition. In this section we shall confine ourselves to the special circumstances to which taxes on imports and exports give rise, and make but passing reference to the general forces of incidence which we have previously described.

Customs duties are subject to several peculiar conditions. For example, there is the political factor, which is not always compatible with economic tendencies, and may occasionally cut directly across them. The precept of taxation "for revenue

only" may be forgotten in the desire to score in commercial warfare over a foreign nation Or the policy may be less openly aggressive, and express itself in a system of protection, nominally, one of defence rather than of offence The success or otherwise of a protective duty depends to some extent, though not of course entirely, on the manner and degree of its transmission

The shifting of all taxes is liable to be impeded by frictional forces, but in the case of customs duties the resistance is specially marked Backward shifting of excise duties is not easy to accomplish, but that of import duties is particularly difficult Similarly, the forward shifting of an export duty is not always so practicable as that of an excise duty in the home market The position is complicated by the fact that the foreign manufacturer is not necessarily obliged to sell his wares in a particular part of the world, and may, if the entrance fee, as it were, be raised, decide to divert his goods to a country that does not impose the same penalty Likewise, the foreign consumer of a commodity that is the subject of an export duty may, if conditions permit, decide to make his purchases in another part of the globe These differences are not fundamental, but they are sufficiently important to make the incidence of customs duties a more intricate problem than that of excise duties

§ 9 Import duties are the chief forms of customs revenues, especially in European countries, and may be examined first In considering whether it is possible to transmit part of the burden to the producer abroad, we wish to know at the outset

whether he is in effective competition with producers both in the country levying the duty and in other parts of the world, or whether he enjoys monopoly powers. Even if there is no rivalry from the home country, competition between different foreign producers may be so keen that certain of them may prefer to pay some of the duty rather than risk a falling-off in their sales. If the foreigner has a monopoly, and is already charging those prices that he finds consistent with the maximum profit, then he may find it inexpedient to raise the prices of his goods. The amount he pays in duties may, in these circumstances, be less than what he would lose in profit if he increased his prices.

But such instances of monopoly are very rare. Even where the foreigner has exclusive powers over the production of a particular commodity, the presence of substitutes, which increasingly come into use when the price of that commodity is raised, may act as an efficient check upon the monopolist's price policy. If, now, a customs duty is imposed or increased, the monopolist's policy may be influenced by the extent, if any, to which the competing products are also taxed. If there is no question of protection or preference, and all commodities of this class are subjected to a proportionate scale of duty, the price of the monopolised product, together with that of the substitutes, may go up by the full amount, causing the incidence to be entirely upon the home consumer. But if there is some discrimination in the duties, and the foreign monopolist is called upon to pay

a relatively higher duty than his competitors, he may be unable to recoup himself in the form of higher prices, and may therefore have to contribute something to the exchequer of the importing country. Whether he will continue to do so depends on certain other factors which we have still to examine.

§ 10. The second condition determining the incidence of import duties is the relative importance of the country's market from the point of view of the producer. It may be that the country imposing the duty is the only one that has a demand for the foreigner's goods. Where there is a consumer's monopoly of this kind, the foreign seller may find it difficult to raise the price of his products. If, on the other hand, the foreigner has a wide choice of markets in different parts of the world, he will prefer to sell in those countries that place the least difficulties in his way. If the consumers in the country that imposes an import duty are unwilling to pay the tax in addition to the ordinary price, he will naturally look out for markets to which entry of his products is free.

Bound up with the above is the further condition of the elasticity of the demand for the foreigner's product. The commodity may be one which is in necessary demand, and for which no adequate substitutes are available. In that event the duty may be added to the price without any shrinkage in the demand, and the incidence, therefore, be on the purchasers. But if the demand, besides being exclusive to the people of the taxing country, happens in addition to be of an elastic nature, the foreign seller is in a weaker position,

and may have to bear the whole of the duty himself. How long he continued to do this would depend upon the extent of his reduced profits and upon his capacity to adapt himself and his resources to more profitable ventures.

§ 11. A fourth condition is the extent to which the commodity can be produced at home. If the article is one which, for physical and climatic conditions, cannot be produced in the country, a rise in price is likely to follow the imposition of the duty, partly because of the tax itself and partly because of the diminished supplies from abroad. (If, of course, the demand is so inelastic that, even though the price goes up by the full amount of the tax, the same amount is required, there will be no question of supplies becoming restricted.) But home production in the past may have been restricted, not through natural inability, but simply because the foreigner could sell the goods at such low prices that only the best situated and most efficient home firms could manage to compete. An increase in prices following the imposition of the duties now affords a measure of protection to the industry, and firms hitherto below the margin begin to provide for the home market. The higher is the level of the new prices, the greater is the inducement for these firms to enter the field.

We thus reach the fifth set of determining conditions, viz. those of varying costs. If the commodity in question is produced under increasing returns (*i.e.* diminishing unit costs), the larger sales enjoyed by the home producers may permit of a reduction in prices. Provided that there is

effective competition among home producers, prices may successively drop, although the duties remain at their original level A firm that previously could not sell its products at the prevailing market price without suffering a heavy loss may now sell them at a lower figure yet make a considerable profit

§ 12 The question of export duties need not be discussed at length Such taxes are now so few that they have little practical significance Here and there we find export duties on natural mono polies such as opium and nitrates, and in these special cases the incidence might seem to be in part upon the foreign buyer But most countries that have ever employed such taxes have long since given them up The export duty on British coal in 1901 was very short lived If there were anything in the contention that these taxes could be shifted to the foreigner, they would doubtless be much more popular than they are at the present time

Those who are interested in tracing the inci dence of export duties need but reverse the reason ing contained in this and the foregoing sections The same basic principles apply It is however, necessary to bear in mind the caution that the sphere of incidence of export duties is likely to be much wider than that of import duties An imported commodity may come from but a few countries, but an exported commodity may go all over the world The problem thus becomes more complicated Also, while it is possible, where de sired, to supplement an import duty with a counter

vailing excise duty, no such support is possible for an export duty This, too, makes some qualification necessary But apart from such minor differences the reasoning proceeds on similar lines and points to corresponding conclusions

CHAPTER XII

STAMP DUTIES

1. Classification of Stamp Duties

§ 1. In 1624, the Dutch Government, hard pressed for revenue, offered a reward to anybody who could devise a new source of taxation. The stamp duty was the result, and the yield was so satisfactory that seventy years later a similar tax was adopted in England. The form that it originally took here was a duty on legal instruments, each sheet of a document being separately liable to tax. There was a specific impost according to the different class of instrument, and it was not until 1797 that the *ad valorem* principle was applied. The stamp duties have had an uninterrupted history down to the present day, although there have been, from time to time, important modifications in the scales of duty and in the instruments selected as the media. In 1891 the Consolidating Stamp Act codified the scheme of duties, providing for *ad valorem* taxes on bills of exchange, promissory notes, etc., penny duties on receipts, cheques, etc., and specific duties on certain other instruments. Several of these rates

were increased in 1920, since which year there have been only small changes

The relative importance of the stamp duties is not as great as it used to be Following the Napoleonic War, the duties yielded over £5,000,000, or approximately 10 per cent of the total tax revenue By 1913 the money yield had nearly doubled, but, in view of the larger Budget, the ratio had fallen to 6 per cent With the enormously increased tax revenues during the next five years the proportion obtained from the unaltered stamp duties declined, representing only $1\frac{1}{2}$ per cent in 1917–18, but, with the temporary improvement in trade in the years immediately following the war, and the higher rates that came into operation in 1920, the aggregate yield from the duties showed an appreciable increase The revenue in 1918–19 was about £12,000,000, or only £2,000,000 more than in 1913–14, but during the last few years it has averaged about £25,000,000, or about 3 per cent of the aggregate tax revenue

§ 2 The stamp duties affect such a variety of acts that it is a little difficult to make a precise classification Bastable[1] makes the following division "(1) Taxes on law proceedings and juridical acts, (2) those on the ordinary commercial instruments, on stocks, shares, etc , (3) taxes on the sale of property, especially immovables, and (4) taxes on gratuitous transfers" But, as this writer recognises, his classification is open to criticism, since, for example, commercial transactions involve transfers of property Also, strictly speaking, the duty on law proceedings should not be regarded as a tax, but rather as a pay

[1] *Public Finance*, p 580 (3rd edition)

ment for the provision of justice. As we have had occasion to point out more than once, a tax should not be confused with a price or a fee. Only that part of the cost of the stamp on legal documents and acts that is in excess of the actual expense involved by the State should be regarded as a tax. In practice, of course, the element of pure tax in the duty on such proceedings varies considerably, and it is impossible to work out the proportion with any accuracy.

Since certain sections of the people make greater use of the legal machinery than others, it might be considered justifiable to make them pay additional contributions to the State on that account. But this view is somewhat short-sighted, for the benefits of justice are by no means confined to those who actually participate in litigation. Most people never have reason to enter the law courts, but they receive advantage nevertheless from the judiciary system. To hamper proceedings by a heavy stamp duty would probably almost certainly interfere with the welfare of the community in general. The benefits of the proper administration of the law should be available for all. We have, in fact, gone a good way towards the attainment of this ideal, for the element in the stamp duties on legal proceedings that represents a surplus over the expenses of administration, and therefore constitutes a true tax, is comparatively small. This is not to imply that the actual amounts are not sometimes excessive, for it is generally agreed that many of our legal proceedings could be shortened and simplified, with no loss of efficiency, but with a great saving in cost. Some would not

be satisfied even with a close approximation of the stamp duties on law proceedings to the most economical cost of administration, but, on the ground that justice is a national rather than an individual matter, and that its benefits, therefore, should be open to all, would propose that the imposts should be reduced much below their present level, even to the point of extinction

Largely, then, because the stamp duties on legal proceedings are in the main of the nature of a fee, and also because we are chiefly concerned with the stamp duties in their economic aspect, we may exclude the stamps on legal acts from our classification and discussion In addition, but only on account of their relatively small yield, we may exclude stamp duties on shipping, certificates and licenses, insurance, etc, which, taken together, yield only about £1,500,000

§ 3 Our observations, therefore, may be confined to stamp duties that have to be paid (1) on the formation of a company, (2) on the transfer of stocks, shares, debentures, and bearer bonds, (3) on the conveyance of land and property, (4) on cheques and bills of exchange, and (5) on receipts This arrangement is quite arbitrary, and logically (2) and (3) might come under a single head, for they are both taxes upon the exchange of goods, as are also, to a smaller extent, (4) and (5) But for purposes of examination it is best, perhaps, to treat them separately, especially as each of the duties presents its own minor problems In examining the economic reactions of the several duties, we shall consider, first, the question of incidence, tracing where possible the

parties who ultimately bear the money burden of the duties, and, secondly, the deeper problem of the effects upon economic efficiency and organisation.

2. The Companies' Share Capital Duty

§ 4. Up to 1920 the duty on share capital was only 5s. per cent, but it was raised in that year to £1 per cent. The revenue, which had averaged little more than £500,000 in the pre-war years, shrunk to less than £250,000 before the end of the war. The post-war boom led to an enormous increase in the yield, which amounted to over £3,500,000 in 1919–20. In the following year, when the duty had been quadrupled, the yield increased to nearly £6,000,000. Since then, of course, the volume of business has been restricted, and the revenue for the last few years has averaged about one-half of the above total.

Is this amount shifted to the customers of the company, or does it form a charge upon the profits of the undertaking and thus fall ultimately upon the shareholders? There seems little doubt that the incidence is upon the owners of the company. The promoters take the charge into account when organising the company, and include it with the many other costs incidental to the formation. The amount of duty, relative to the total capital, is so small that the directors are unlikely to take the charge specifically into their calculations when fixing prices, even where they are in the fortunate position of being able to determine the prices at their own discretion. The fact, too, that the duty is non-recurring creates a tendency for it to be capitalised, as it were, from

the start, causing subsequent price movements to be little affected by the initial outlay in duty.

It is not denied, of course, that the company will transmit the charge if it has the opportunity, but the opportunity is seldom present. In the first place, there is the competition of the rival companies, many of which were possibly in existence when the duty was only 5s. per cent. Whether or not, in their early days, they were fortunate enough to recover the amount from the customers, it is doubtful whether they would still take the charge into account in estimating their costs. And if they did, it would be at the lower scale, thus having an advantage equivalent to 15s. per cent over the owners of the new companies. Further, there might be firms in competition which have not become incorporated, and have therefore no reason for regarding the duty as an item in costs. The proportion of such businesses is admittedly becoming smaller, but the existence of one effective concern of this kind may be sufficient to prevent the share capital duty from being passed on.[1]

§ 5. The criticism of the share capital duty, as being prejudicial to industry, rests on several grounds. The duty, it is maintained, might hinder the normal development of company organisation which is so essential to modern economic enterprise. It might hamper the accumulation and the most advantageous use of capital. It might deter foreigners from establishing companies in this country. It might induce British promoters to register new ventures abroad.

[1] The company would hardly be in a better position for shifting the duty if it had a monopoly. See above, pp. 111-115.

And it might discourage the amalgamation of businesses that were genuinely in need of combination and unification.

These are the principal adverse effects which the critics attribute to the operation of the share capital duty, and it must be admitted that such fears would be justified if the duty bore a high proportion to the capital involved. The question is chiefly one of amount. Is the prevailing rate of duty so high as to restrain capital accumulation and business enterprise? Or is the ratio sufficiently low to ensure that the initial charge is more than balanced by the advantages of incorporation?

As in many other problems of this kind, it is impossible to estimate what the position would have been had one of the factors been absent. It is conceivable that, if the duty did not exist, there would be a greater number of companies and possibly a larger accumulation of capital. There are several bodies which believe that the weight of the duty, especially if taken in conjunction with the conveyance duty, is severe enough to have this restraining effect. The Law Society, for instance, in evidence before the Colwyn Committee, submitted that " were it not for this heavy impost, the number of registrations would undoubtedly be larger ".[1]

The considerable number of registrations, however, in recent times seems to give little support to this notion. It may be that, in years when business formation is comparatively sluggish, the influence of the duty at the margin is not altogether negligible. But in ordinary times the rate of company formation

[1] Colwyn Report, p. 205.

does not appear to be visibly affected by the duty It is equally improbable that foreigners have been discouraged by this duty from organising companies here, or that British business men have been induced thereby to register new companies abroad, particularly in view of the fact that the United Kingdom is by no means the only country in which this type of duty is to be found

On the whole it is unlikely that the capital share duty has a material effect upon the formation of *new* companies The duty is very light, and is non recurrent Regarded over the duration of the average company's activity, the burden is not severe, and is, on the whole, much more than counterbalanced by the privileges and advantages that the company enjoys over the private business The duty, too, is among the smallest of the several expenses incurred on the formation of a company and therefore slight alterations in the rate are, in general, unlikely to have an appreciable bearing upon the policy of the promoters

§ 6 But the influence of the duty upon incorporation, involving the reorganisation or amalgamation of *existing* companies, cannot be so lightly dismissed It is reasonable that a private business, on acquiring the status and rights of a company, should pay some thing for the privileges But once a company has been formed, and paid these dues, there is much to be said in favour of exempting it from further charges of this kind, should it at a later time engage upon a scheme of reconstruction It may be urged that amalgamation with other undertakings will presumably in added advantages, which will permit

of the payment of a further duty. There is, however, this important difference. When a company is established for the first time, considerable benefits are conferred upon the owners of the business by the laws of the State relating to limited liability. Without going so far as to accept the principle that a tax is a payment for a specific service rendered by the State, there is much to be said in favour of making a new company, on its formation, pay something as a recognition of the new legal advantages that it will enjoy. When, on the other hand, an existing company merely alters its form, it will not, as a general rule, be endowed with any legal rights that it does not already possess. Here and there, it is true, the legal powers of the reconstructed company will be strengthened, and it will be possible to give effect to arrangements and contracts that formerly could not always be enforced. Two independent firms, for example, might agree to adopt a certain business policy, but, if a dispute arose, the agreement might be held to be in restraint of trade and therefore invalid. Combination of the two firms would overcome such difficulties. Such new legal privileges as might be attained, however, are rarely the chief motive for amalgamation. In most cases the expected advantages of amalgamation are internal. Technical methods can be improved, production concentrated in the most efficient plants, wasteful overlapping eliminated, a common sales policy adopted —these and many other economies are the chief aims of a centralised administration. Additional privileges conferred by the State are inconsiderable, possibly non-existent. On this ground, therefore,

there is little justification for the payment of the capital duty a second time.

In view of such considerations, and the desire to remove as many obstacles as possible in the way of the "rationalisation" of industry, Parliament in the last few years has appreciably modified the conditions under which the share capital duty has to be paid. In 1926 the government, recognising the need for the reorganisation of the coal-mining industry, provided for exemption, within certain limits, of amalgamations of colliery companies. In 1927 relief from this (and the transfer) stamp duty was extended to business reconstructions in general, subject to the conditions, among others, that the shareholders in the new company were the same as in the old, and the shares were held in the same proportions. By the Finance Act of 1930 this concession was slightly widened, and certain types of company formed for national purposes were rendered exempt from the capital duty.

3. The Duty on Transfer of Stocks and Shares

§ 7. The stamp duty on the sale of stocks and shares has something in common with the duty on share capital. Not only does the State exact revenue when a company is formed, but it also takes advantage of subsequent sales of shares by imposing a duty of £1 per cent at each act of exchange. The duty is very remunerative, yielding an average of approximately £6,000,000 during the last few years. It accounts for about one-quarter of the total revenue

from stamp duties, and is easily the most prolific source of revenue in its class.

It is not an easy matter to trace the incidence of this duty. There are three parties among whom the impost may be distributed—the seller, the middleman, and the buyer. The degree in which each of these parties contributes to the Treasury depends largely upon the general conditions of sale and purchase that we have previously discussed. There seems to be no clearly defined rule that can be applied to this problem. Under conditions of eager buying some of the duty tends to be borne by the purchasers, while under the opposite conditions the sellers may have to accept lower prices than would prevail in the absence of the tax. Though some maintain that the duty tends in part to fall on the broker, there is little evidence to warrant this conclusion. The immediate impact is on him, it is true, but the burden is promptly transferred to one or other of the principals to the transaction. Otherwise the agent would be at a severe disadvantage as compared with middlemen in other branches of exchange. Whether the duty is further shifted, deliberately or otherwise, from the principals to other persons, directly or indirectly involved, depends on circumstances that are so numerous and various as to make generalisation very difficult.

There is, however, a certain tendency for those who first offer the stocks and shares for sale to bear an appreciable part of the duty themselves, for in the initial quotations some note must be taken, however indirectly, of the liability to tax. It is important to observe in this connection that, as govern-

ment securities are exempt from the duty and municipal stocks pay composition only (the burden in the latter case falling on the ratepayers), the promoters or underwriters of a new industrial issue are at a slight disadvantage in disposing of the shares Thus, part of the burden of the duty may, through a form of capitalisation, be borne by the original sellers, relieving in some measure the real charge falling upon subsequent owners The possibility of capitalisation is especially noticeable when a duty of this kind is suddenly imposed or increased When, for example, the rate was increased in 1920 from 10s to £1 per cent, there was, for the time being at any rate, a certain restrictive effect on dealings, and the promoters and underwriters probably had to agree to slightly lower quotations than would have prevailed under the previous scale of duty

§ 8 On the question of ultimate effects it is easier to pass a rough judgment, although even here there can be no absolute certainty Dealings in stocks and shares are, to some extent, in a class of their own, and the profits therefore are not constituted in quite the same way as the proceeds of ordinary industrial and commercial ventures The factor of reward for risk is more prominent, as is also the element of chance or "conjunctive" gains In so far as the stamp duty falls on the latter, there is little opportunity for further shifting The position is analogous to that of a duty on monopoly revenue Such a tax, if it could be contrived to fall in this way, would be advantageous to the nation as a whole, in that it would yield an appreciable revenue with practically no damage to the economic capacity

of the nation. It would fall upon "surpluses" rather than upon production "costs", and in that manner it would satisfy the requirements of a sound tax.

But, if the stamp duty could be shown to restrict legitimate enterprise and risk-taking, the possible uneconomic effects could not be so lightly brushed aside. This is, in fact, the chief criticism that is directed, both by certain economists and by business men, against the duty. It is maintained that speculative dealings, apart from their liability to abuse, play an important part in the modern system, and that anything which serves unduly to hamper them is apt to impede normal economic progress. Furthermore, so it is contended, since legitimate speculation serves to adjust long period supply to demand, and therefore to smooth out price fluctuations, a duty which restrains such dealings may have the effect of widening the limits of price movements, with consequent uncertainty and unevenness in the state of trade.

It is almost certain that so remunerative a tax as the duty on transfers of securities has some restrictive effect on the extent and rapidity of exchange. In so far as it curbs the speculative action of imperfectly informed sellers and buyers, it doubtless has a beneficial result, for the evils commonly associated with speculation spring as much from unskilful dabbling in the share market as from the activities of the expert dealers. On the other hand, in so far as it hinders the free sale and purchase of securities, it is liable to widen the range of price fluctuations, causing the ultimate burden to rest on the general investing public.

§ 9. There is, in addition, the criticism that the duty on stock exchange dealings is relatively too high, as against other duties of a similar kind, in that the form of wealth on which it is imposed is exceptionally mobile and is subject, more than the average, to change of ownership. For example, the duty on conveyance of land is of the same amount, but, as exchange occurs much less frequently, the total burden, on the score of duty, is not nearly as great. On the other hand, however, land conveyance involves other expenses to which dealers in securities are not subject, and thus the balance is partly restored.

§ 10. Bearer bonds do not figure very largely in the finance of this country, as is evident from the small revenue from the duty. Although the rate is twice as high as that on the transfer of stocks and shares, the revenue has averaged less than £1,000,000 during the last few years—*i.e.* less than one-sixth of the yield of the duty on registered securities. The higher scale is supposed to provide a composition for the ordinary transfer duty, but it is obviously an arbitrary proportion that bears no exact relationship to the rate of transference.

To increase the duty, however, to a figure that would, as it were, capitalise the duties that are ordinarily imposed at each act of exchange might have a prejudicial effect on the volume of business in such bonds. Even at the present scale there are certain authorities who believe that the existence of the £2 per cent duty is detrimental to the British financier in competition in the foreign loan market with his American rival, who is not required to pay

such a duty. American financiers have not in the past taken the same interest in foreign loans as we have, and the small impost in this country has perhaps been more than balanced by other advantages that we have enjoyed. But, with the doubling of the duty, and with the increasing favour with which Americans are coming to view foreign investments, there is some apprehension that the present duty may have a deterrent effect.

The incidence of the duty on bearer bonds tends to be on the borrower, who in this case is usually of foreign nationality. It would not, however, be correct to say that the duty singles out the foreigner for special attack, since a composition rate, that is equivalent to the ordinary duty on two transfers only, cannot be regarded as excessive.

4. The Duties on Conveyance, Cheques, and Receipts

§ 11. The duty on conveyance of land and property ranks next, in point of yield, to the duty on transfer of stocks and shares, having provided the Exchequer in recent years with an average of a little under £4,000,000. It is impossible to calculate exactly to what extent this amount falls upon sellers and buyers respectively. As in the case of other taxes on acts of exchange, the resting-place of the money burden is governed largely by conditions peculiar to the individual transactions. Where the buyer is anxious to obtain possession of the property, the whole of the duty is likely to be borne by him. Where his desire to buy is not as intense as the desire

of the owner to sell, the charge tends to fall on the seller. So far there is nothing exceptional about the incidence of this duty. A special circumstance, however, is to be found in the liability of the purchaser to meet the duty again in the event of re-sale, thus causing him to offer a little less, perhaps, than he would be willing to pay in the absence of this future liability. To that extent the incidence of the duty would tend to be on the seller.

Whether the duty is high enough by itself seriously to militate against the transfer of land and property is open to question. The duty is only one, and not the largest, of many charges attendant on the sale of land. It may happen that, in a particular negotiation for the transference of some property, the conveyance duty is heavy enough to turn the balance against the transaction—though the same might be said of any of the other incidental expenses. Where the duty has to be paid in addition to the companies' share capital duty, the cumulative effect is likely to be more serious.

§ 12. The yield of the duty on cheques is only slightly less remunerative than that of the duty on the conveyance of land and property, yielding during the last few years an average of about £3,500,000. The question of the incidence of this duty is fairly straightforward. Where a person draws a cheque in settlement of a private account the duty tends to be on him alone. But where the cheque is drawn in connection with a business transaction, it may be generalised that the duty is embodied in the general costs of the commodity or the service, and passed on to the consumer. There is no graduation or differ-

entiation of the duty, and, as it falls on the marginal as well as on the more prosperous firms, it enters into the price-determining costs, and thus tends to be shifted to the purchaser of the product.

It is doubtful whether the doubling of the duty in 1918 had a material effect on the use of cheques. It does not follow, of course, that the steady annual increase of about 5 per cent in the number of cheques during the last decade disproves any restrictive tendency of the higher duty, for possibly the rate of increase would have been still greater had the duty remained at the original amount. Possibly, too, the increased duty has influenced some people to draw fewer cheques, though for larger amounts, than in the days of the penny duty. And it may be that the higher duty has encouraged the use of bank-notes. But when all these considerations are taken into account, there does not appear to be much force in the contention that the double rate of duty has materially interfered with the employment of the cheque as a medium of exchange.

§ 13. The revenue from the duty on receipts cannot be ascertained with any accuracy owing to the use of ordinary postage stamps on the forms of receipt. Treasury officials estimate, however, that the yield is approximately £2,000,000 a year. They are of the opinion that the doubling of the duty has not appreciably affected the number of stamped receipts. The duty would appear to be shifted in a similar manner to that of the cheque duty. When the transactions are of a private nature the charge usually remains with the drawer, but in ordinary business dealings the duty is included in the total

costs of the undertaking and tends eventually to be transmitted to the consumer

The economic effects of the receipt duty do not seem to be serious Where any liability exists for the duty to impede a business transaction the difficulty may be overcome by the simple device of not giving a receipt at all It is the ease of avoidance that makes it impracticable to institute a graduated scale of duty Down to 1853 there was in fact a graduated duty rising to as much as 10s on receipt of £1000 or more but largely owing to widespread avoidance the flat rate of a penny was introduced in that year The revenue in the subsequent years showed a marked advance but whether this was due to a diminished reluctance to stamp receipts or simply to an increase in the volume of trade it is difficult to say

§ 14 The outstanding conclusions from the discussions on the principal stamp duties may be briefly reviewed All these duties are open to the general criticism that in some degree they tend to restrict the normal flow of industry and trade and do not therefore obey the canons of sound finance Certain of the duties being on a *pro rata* basis may entail the payment of considerable sums and may have therefore a deterrent effect Others are so small that the economic reactions to which they give rise are very slight if not altogether negligible

The duty that has to be paid on the formation of a company comes in the first category for there is a certain danger that the initial charge may retard genuine economic development The defect is especially noticeable in the case of business reconstructions that do not conform to the conditions permitting

exemption from duty The imposts on transfer of securities, on bearer bonds, and on conveyance of land and property, have doubtless a restrictive effect on the exchange of these forms of wealth Anything that unduly interferes with the free movement of goods is open to criticism on several grounds An advanced division of labour and complex economic organisation necessitate a system of free sale and purchase, and anything that obstructs this interchange is liable to reduce the productive capacity of the nation There are some forms of wealth, too, especially land, which can be better utilised by people other than the present owners, but the heavy duties, in conjunction with other charges, often prevent the desirable change of ownership from being effected

The duties on cheques and receipts are the smallest in amount, and involve the least economic damage In a small way they may curtail the volume of business transactions People have become habituated to the charges, however, and, as a special virtue is supposed to attach to a long-established duty, there is little probability of their disappearance

CHAPTER XIII

LAND TAXES

§ 1 The land tax now plays but a very small part in the scheme of British national finance During the last few years the income from this source has averaged about £700,000, i e less than 1 per cent of the total revenue The amount of attention usually given by writers on public finance to the land tax would hardly seem to be justified by the comparatively small yield of the tax, were it not for the fact that there are other taxes that are based upon the land, and that the revenue from these is much more considerable Schedule A of the income tax comprises income from ownership of land and buildings Schedule B includes profits from the occupation of land Then there is the duty on mineral rights, the only surviving impost of the scheme of land value taxation laid down in 1909 and repealed for the most part in 1920 And, finally, there is the system of local rating in which the land factor plays an important part Thus, although the land tax in its original guise is now a very minor source of revenue, it has become supplemented by other and more remunerative duties that have land and buildings as

their basis The total income from these sources is not so considerable, relative to the total, as in some countries, but it accounts none the less for an appreciable proportion of the aggregate tax revenue

In this chapter we shall deal mainly with the subject of incidence In view of the small yield of the land tax, and of the possibility of capitalisation, the question of economic effects is included in the general discussions elsewhere on the taxation of this form of property

§ 2 The incidence of a tax on land naturally depends on the form that the tax takes A duty that is calculated according to the physical extent of the land falls in a different manner from that of a tax that is based on the productiveness of the land In the early days of land taxation the area was taken as the chief standard, but this method was found to be just as crude and unsatisfactory as the poll taxes that were imposed on every person, irrespective of his individual capacity to pay In nearly all systems of land taxation at the present time chief regard is given to the productiveness or the value or the rental of the land in estimating the duty that has to be paid

Incidentally, it is interesting to observe the outstanding difference between the English and the American methods of land taxation, and their respective economic consequences In this country the rental is taken as the basis, whereas in the United States it is the capital value that is selected There the duty is usually 1½ to 2 per cent of the selling value of property, and is responsible for over a half of the revenue of the central or provincial

governments. The method is far from perfect, and, in the absence of rigid surveillance, lends itself to serious abuses. It has, however, the merit of inducing the owner to make full use of his land, which is assessed largely according to its potential economic value. Also, a portion of the "unearned increment", that may come about through the pressure of increased population or through public improvements, is thereby appropriated for the benefit of the community.

§ 3. Taxation on a basis of rental raises important issues which are by no means confined to land revenue alone. The classical theory of the incidence of a tax on economic rent is that if the charge is directly levied upon the landlord it cannot be shifted; that if it is imposed in the first place on the tenant it must eventually be transmitted back to the owner. Although, as we shall observe later, the theory is subject to certain reservations, its main implications cannot be disputed. Since the principles involved are of wider application than to land taxation alone (reference has already been made to their relationship to the taxation of monopoly profits), we may, at this stage, consider them in more detail.

We have previously shown that the price of a commodity tends, on the side of supply, to approximate to the marginal cost of production. The relationship between the price of agricultural produce and the marginal unit cost can be simply demonstrated. Land differs enormously in natural productiveness, but the growers sell at a fairly uniform price. Competition prevents any marked difference

between the prices of similar grades of produce, even though there may be a wide variation in the quality of the lands on which they are grown. Thus, we can imagine that the owner of the best grade of land, A, would make a large profit on his produce if he cultivated the land himself. The next best land, B, would yield a profit, but less than that obtained from A. The third-grade land, C, would yield the minimum net reward that is required to compensate for its cultivation. The fourth-grade land, D, is not fertile enough, or is not sufficiently well situated, to make cultivation worth while, for the unit cost would be higher than the selling price of the produce. In short, the price of the goods, which is fixed for the producers by the interplay of demand and supply, determines what shall be the marginal land—in the above case, C. If, for some reason (*e.g.* a war, which cut off foreign supplies), the price were to rise, the margin of cultivation might fall to D. If, on the other hand, the price were to fall, the margin might rise to B.

It needs little proof to show that, if the owners of the superior lands decided to let their property to tenant cultivators, the rent they would charge would be governed by the relative productivity of their land. The rent of land A, for example, would be greater than the rent of land B by the money equivalent of its greater productivity. Similarly, the rent of land B would be greater than that of land C by the equivalent of its superior output.

§ 4. Each grade of land, then, bears an economic rent equal to its differential advantage over another grade of land. What is the ultimate grade by which

the superiority and, therefore, the rent of the other grades is measured? The answer, in the traditional economic argument, is the marginal land. The cost of producing crops on this land (in which we include the minimum return for wages of management) is just covered by the selling price, leaving no surplus for the rent of the land itself. The marginal land, so the classical argument runs, bears no rent; and the better grades of land bear a rent that is determined by their respective degrees of superiority over the marginal land.

The notion of a "no-rent" land would appear strange to many, especially to the farmer who has to pay something for what he considers to be the poorest of land. But the conception is not so unreal as might at first appear. In many properties for which a gross rental is paid there are certain portions that would not be worth hiring, if it were possible to segregate them from the rest. The rent is really determined by the productiveness of the fertile parts of the property, and thus, in effect, some "no-rent" land actually exists. Secondly, it is not necessary that the marginal land should be in this country. If every acre of ground in Britain were of first-grade quality, and bore a high rent, the theory would not be disproved. The price of British produce is largely determined by conditions of foreign supply, particularly in the market for wheat. The "no-rent" land in these circumstances might be abroad, yet that would not upset the contention that the rent of British land is determined by the differential advantage over the marginal land. Thirdly, the theory applies only to

the net economic rent that arises from natural or situational superiority. It does not apply to that part of the rental which represents interest on sunk capital. There are unquestionably many tracts of land, the hire charge of which is fully accounted for by the interest on the invested capital, leaving nothing for economic rent in its strictest sense.

§ 5. It may be provisionally concluded, therefore, that, as the marginal cost is equal to the price, and as there is no element of economic rent in the marginal cost, a tax on the economic rent cannot be shifted to the consumer. For any attempt on the part of the owners of the superior land to transmit the charge would be offset by the competition of the marginal owners who are free from the tax. Also, when sufficient time is allowed for leases to terminate and be drawn up again, the tax cannot fall on the tenant farmers, for they will pay no more for land than represents the surplus over and above the net cost of production, including their wages of management. If they were called upon to pay the tax, the amount they could pay in rent would be reduced, causing the burden to be in effect upon the landlord.

In practice, however, a specific tax on net economic rent is seldom encountered. In local finance, as we shall observe later, it would seem more possible to fix the rates according to the net rent of land and buildings, although even here it is rarely practicable to distinguish between the burdens falling on pure rent and those falling on interest and other charges. In national finance it is still more difficult to impose taxes directly on the surplus.

The Act of 1909, following a long agitation, provided for a tax on increments in land values, but the cost of valuation was so heavy and the yield so small that, with the exception of the duty on mineral rights, the provisions were repealed in 1920. Ten years later the project, which never lost its appeal to certain fiscal reformers, again appeared in a Budget speech.

§ 6. We are concerned, however, not with the merits or demerits of a tax on land values, but with the long-established forms of land taxation and the nature of their incidence. Under the prevailing method a large proportion of the burden falls, in effect, upon the return to the capital invested in the land, and this necessitates an important qualification of the theory of incidence that we have just outlined.

The essential difference between land, in the strict economic sense, and capital is that the former is rigidly fixed in quantity while the latter can, especially over a period of time, be adapted to changing circumstances of demand. An increased pressure on land supplies sends up the economic rent, but no more land is brought into existence in consequence. An increased demand for capital, however, raises the rate of interest only temporarily, for, with the greater earnings of capital, fresh supplies are usually soon forthcoming. If, on the other hand, the demand for both falls off, the supply of land cannot be restricted, and the landowner must be content with a lower rent, whereas the supply of capital gradually contracts so as to conform to the new condition of demand. The

interest of capital tends, therefore, to remain more stable than the rent of land

The bearing on the problem of incidence is important The quantity of land being predetermined, the imposition or increase of a tax cannot have a material influence on the supply The landowner is thus in a comparatively weak bargaining position, and may ultimately, as we have shown, be made to bear the burden of the tax But the capitalist has a greater control over his supplies, and, unless a certain reward is forthcoming, the amount of capital available for production will fall off, and the national wealth and income will suffer Hence, it may be generalised that a tax can rest on the owner of capital only to a limited extent, and that, once it threatens to encroach upon the minimum amount that is required to induce a regular flow of new capital, the charge must be shifted It may be shifted backward if the landowner still enjoys a portion of the economic rent that has escaped taxation More likely it will be shifted forward to the consumer of the produce

§ 7 The problem of the incidence on improved land is not, however, as straightforward as the above reasoning would imply, for, in order to simplify the argument, we have been assuming that the landowner and the capitalist were distinct individuals, and that the capital sunk in the land could be treated separately from "the original and indestructible powers of the soil" Neither of these assumptions, however, is warranted by the facts

The landowner and the capitalist tend in this case to be one and the same person No landowner who

has any regard to the future permits his property to go uncared for, relying entirely upon the natural powers of recuperation. Some capital outlay on his part is almost indispensable, until eventually it may be quite impossible to say whether a piece of land owes its value in the main to its pristine qualities or to man-made improvements. Or the capital outlay may have been undertaken by a tenant, in which event there may have been for a time—probably for the duration of the lease—some account kept of the specific charges under each head. But eventually, with the expiry of the lease, the two charges become almost imperceptibly merged into one, until it is impossible to distinguish with any precision between the economic rent and the interest.

In the long run, then, it is impracticable to consider the capital improvements separately, and the land must be treated as an indivisible whole. The incidence of the tax works out in the same way as if the charge were laid on the land in its original natural condition. But in the short run, and especially when a new tax is under consideration, the two factors should be kept as distinct as possible, inasmuch as the liability at any given time for land to be taxed affects the quantity of capital that is invested in it.

§ 8. To sum up so far, a tax which falls on the net differential rent, so far as it is possible to isolate and estimate this element, remains with, or is eventually transmitted to, the landowner. The marginal producer, as we have explained, does not have any pure rent charge, and, since the price approximates to marginal cost alone, a tax which is

laid on the surplus over this cost does not affect the consumer. But that portion of the tax which falls on the return to capital must, for some time, have some bearing on prices, for it affects the marginal producers as well as those who cultivate superior land. Marginal costs are increased, and therefore the consumers have to pay more for the produce.

It must be repeated, however, that the distinction we have drawn between the incidence of a tax on pure rent and the incidence of a tax on the return to capital holds good only for a limited period. Difficult as it is in the short run, it is impossible when several years have elapsed to keep the accounts separate. It may be generalised, therefore, that in the long run the tax on the revenue from land falls in practically the same way as a tax on pure rent.

§ 9. The above theoretical conclusions are not always borne out in practice. The tendency for a tax on land to fall ultimately on the landowner is frequently offset by frictional forces, and the charge very often, perhaps through ignorance or sheer inertia, remains at the point where it was first imposed. Conversely, a remission or reduction of a land tax is not certain to benefit the parties who, according to theory, ought to derive the advantage. For instance, in so far as the rates on agricultural land fall on the landowner, the remission under the new rating scheme should, theoretically, work out to his personal benefit, by increasing both the rent he can charge for his property and, on the same basis, its capital value. The fact, however, that the legislators expect the main advantage to accrue to tenant farmers as well as to those who own the land points

to a disbelief in the complete operation of the economic law.

§ 10. But what of the land tax that does not take the form of an impost on economic rent? In particular, what is the incidence of the tax that represents a fixed annual charge—the kind with which we in this country are familiar? The general principles governing the incidence of such taxes have already been explained. The possibility and the degree of shifting depend on the extent to which the conditions at the margin of production are affected, and, further, on the elasticity of the demand for the product. If the tax falls in such a way as to hit the marginal producer as well as those better situated, a rise in the price of the product is almost certain, and can be prevented only if the demand is extremely elastic. In the latter event the marginal producer may be compelled to give up production, or at any rate abandon that part of his activities which is the least remunerative.

§ 11. A tax that recurs annually as a fixed charge, exemplified in England by the old land tax, tends to become capitalised at its inception and gives colour to the idea that "an old tax is no tax". Not only does the original owner, at the time of imposition, have his net income reduced by the amount of the charge, but he suffers, in addition, a diminished capital value of his property, as becomes evident if he sells it on the market. The purchaser naturally takes the recurring duty into account when calculating his offer. He hands over a smaller capital sum than would be required in the absence of the tax, and from the capital saved he may be said to draw

in effect a corresponding income. The subsequent payments of duty are more or less equivalent (assuming stable conditions) to the interest from the capital sum first saved, and the tax appears to be "burdenless" in consequence—a view, however, which the average landowner would find it difficult to accept.

§ 12. In reality the incidence of the land tax does not always work out in this way. In the first place, there are the frictional forces already mentioned. Secondly, conditions are not usually as stable as the above reasoning presupposes. Even though the annual charge itself remains constant (the primary condition of capitalisation), there may be considerable changes in the value of property, especially if the product, as in the case of agriculture, is subject to wide price fluctuations. Professor Seligman considers the principle of capitalisation to be more applicable to urban than to agricultural lands for the reason that the former is less subject than the latter to fluctuations in value on account of variations in the price of the product.

Also, as the same authority points out, "even if capitalisation does take place, we must remember that the new purchaser of agricultural land is rarely aware of the process or, if he is originally conscious of it, soon forgets it. His profits are so entirely dependent on the mutations in the price of his produce that he invariably reckons his taxes among his outgoings, and resents paying at a higher rate than do the owners of other property. The statesman cannot afford to ignore this psychological fact in framing his budget."[1]

[1] *Shifting and Incidence of Taxation*, p. 270.

Still another criticism of the capitalisation theory, though in a rather negative fashion, is to the effect that, if the tax were to be removed, the income of the owners and the selling price of their property would be correspondingly increased The tax, therefore, would not have been fully capitalised, instead of "disappearing into air" with the passing of generations, it would have continued to be a real charge until legally remitted Thus, for example, when Parliament in 1894 decided to exempt people with incomes below £160 from the payment of land tax and to exempt others with slightly larger incomes from half of the standard rate, those responsible for the measure virtually admitted that the charge was a true tax, and not capitalised in perpetuity by former generations Had the impost been as "burdenless" as some made out, there would have been no point in granting these exemptions In view of such criticisms the "amortisation" theory is not nowadays held in the same favour as was formerly accorded to it

CHAPTER XIV

NATIONAL AND LOCAL FINANCE

1. The Growth of Local Rates and Expenditure

§ 1. In the early days of government there was little point in the distinction between national and local finance, for the political units were so small and the range of activities so confined that the administration was necessarily on a restricted scale. The undertakings of some of the largest nations of ancient times would be overshadowed by those of ordinary municipalities of the present day. With the growth of population, however, and the gradual absorption by larger of smaller nations, the need for a division between central and local functions gradually evolved. Hitherto, in a comparatively small territory, the people had been in close contact with the governing body, and an intermediate authority would have been superfluous. But, as the nation grew in population and extent, direct relations became more difficult. The government found itself burdened with an ever-growing number of duties, while the citizens could no longer depend on the central authority to take an efficient interest in localised affairs in every

part of the kingdom Even if the government had been inclined to administer directly for local needs it would have found itself handicapped by the lack of knowledge of the special circumstances of the several areas As the nation grew, therefore, the need for devolution and some minor form of political organisation became imperative

§ 2 The manner in which the subdivision of functions between the State and the smaller authorities took place was very haphazard In no two countries did it develop on identical lines, with the result that there is no uniformity in the apportionment of tasks or in the raising of revenues The differences are due in the main to historical and geographical circumstances Powers and functions that were originally devised for meeting immediate needs, with little regard to wider issues gradually acquired a degree of permanence The central authority in different countries came to have a far from uniform control over the local bodies For instance, while the British Parliament has legal rights, if it ever cared to exercise them, to abolish the present division into counties and parishes, the United States government has no such powers The individual States have definite inalienable rights, they existed as political bodies before the formation of the central government, and in the national constitution were accorded privileges which the British local bodies do not possess

Thus, local finance plays a larger part in the United States than in Great Britain, partly because of the size of the administrative unit, and partly because of the relative weakness of central control

The individual States have adopted methods of raising revenue that are beyond the powers of British local authorities. For example, they rely for over a half of their income on the general property tax, and have considerable powers in the matter of assessment. Some of the States have an income tax in addition. Direct taxation, in fact, is one of the characteristic features of American local finance as contrasted with the methods in this country. On the other hand, the system of grants-in-aid from the central Exchequer to local authorities has a much more important place in British than in American finance.

Municipalities in some European countries still depend on *octrois*, *i.e.* local import and export duties, for much of their revenue. France, Italy, and Spain, in particular, are disposed to this form of taxation. Tolls on goods passing through towns or going to market used to be levied in England, but the practice has long since ceased. There is little economic justification for *octroi* taxation, and where it persists the reason is to be found mainly in the people's inertia, and in the long-established tax-raising machinery to which the citizens have become habituated. In Paris, for example, the system has been so long in use, and results in such a considerable revenue, that, despite the admitted defects, it is likely to continue.

§ 3. The British system of local rating and expenditure goes back several centuries. Though it is usual to start the modern history with the codifying legislation of Elizabeth, the beginnings are to be found some centuries before. From early times

rates were imposed both for local and for national purposes. In the reign of Edward I citizens who wished to repair the walls, bridges, or streets of the town had to apply to the king for a grant of "murrage", "pontage", or "pavage". The royal council in Parliament would impose what was the equivalent of a local rate for this purpose. The methods adopted for raising the money, however, did not always accord with the canon of ability, nor did they exact the most where the benefit was the greatest.

The social difficulties of the sixteenth century were responsible for the institution of the poor rate, which became the model for nearly all subsequent local taxes. In 1551 it had been enacted that in every town a book should be kept in which were written the names of householders and of those in destitution. The townspeople were to be exhorted by the parson, and later by the bishop, to give alms for the impotent poor. But the voluntary system had by then almost broken down, and in the Act of 1601 compulsory assessment was for the first time introduced. In each parish there was to be "taxation of every inhabitant, parson, vicar, or other, and of every occupier of land, houses, tithes impropriate, or proprietors of tithes, coal mines, or saleable underwoods". The criterion of ability was not definitely laid down in the Act, but it came ultimately to be the value of immovable property in the occupation of the ratepayer. The Parochial Assessment Act of 1836 defined the basis of rating as the net annual value of any hereditament, *i.e.* the rent that accrues after maintenance and other charges have been deducted. Though important

modifications have since been made, the principle still dominates present-day rating.

2. National and Local Functions

§ 4. The fact that there has not been any uniform practice in the methods of raising local revenues is partly attributable to the absence of a universally accepted division of functions between the central and the local government. In some countries the rights of the smaller bodies are very prescribed, and permission for almost every important undertaking has to be sought from the national authority. In other countries the local bodies possess considerable powers of autonomy.

There are certain functions which must be undertaken by the State. Where the interests of the population as a whole are concerned, it is undesirable that any but the central authority should provide the necessary services. Also, where unity of policy and co-ordination of activities are essential, there is a strong case for parliamentary control. On the other hand, there are many functions which are best carried out by the local authorities. Where the conditions and needs of a particular district require special knowledge and provision, or when the service is of an exceptional kind, determined by the particular circumstances of the district, the people on the spot are usually best able to deal with the situation. Similarly, where the duties are such that they require constant and detailed supervision, local responsibility is usually productive of the best results.

For example, there can be no question that the

central government is the proper authority for organising the national defences. Even in those countries in which the sectional bodies have considerable powers, the right to engage in dealings with foreign governments and to provide for the military and naval forces is invariably in the exclusive possession of the State. The postal system must, in the interests of unity and economy, be under the control of a central body. So must the issue of coinage, the scheme of weights and measures, and all other such instruments and agencies that facilitate national intercourse and trade.

§ 5. Of the functions undertaken by local authorities—water supply, lighting, sanitation, police protection, education, and so on—there are many which obviously could not be adequately or economically carried out by the State. That is not to say, however, that the nation as a whole has no right to intervene where the service is being inefficiently administered by the county or the municipality. In J. S. Mill's well-known words: "It would not be a matter personally indifferent to the rest of the country if any part of it became a nest of robbers or a focus of demoralisation, owing to the maladministration of the police; or if, through the bad regulations of its gaol, the punishment which the courts of justice intended to inflict on the criminals confined therein (who might have come from, or committed their offence in, any other district) might be doubled in intensity, or lowered to practical immunity".[1]

The function of police protection is, in fact, not well defined. Defence against aggressors abroad is

[1] *Representative Government.*

admittedly a national duty, while administration of the high courts of justice is also in the hands of the State. Logically there is little reason why the police forces also should not be included in the same category. Actually, of course, the State makes substantial grants to local authorities towards the cost of the police, but there are many who urge the transference of full responsibility to the central authority. The present system of dual control is defended, partly because it is the outcome of a long evolution, and a sudden transference of the services would create as many new problems as those it solved, and partly because under the existing arrangement a closer supervision over the efficiency and integrity of the service is made possible.

The same mode of reasoning could be applied to several other functions which are largely administered by local authorities. If the water supplies or the sanitary arrangements of a district are below the standard considered necessary for the maintenance of full health, the rest of the country cannot look on with equanimity. Epidemics know no municipal or county barriers. Also, the benefits of such services as education cannot be confined to the areas in which the instruction is given. Some financial assistance and central control is essential if the national minimum standard is to be maintained.

§ 6. It is mainly for historical reasons that we still continue to deal with destitution to a large extent on a local basis. The Elizabethan legislation, while substituting a compulsory for a voluntary system, defined the practice by which the administration of relief was left to the officials of the parish. The policy

was reaffirmed later in the Law of Settlement, 1662, whereby destitute settlers in a parish could, within forty days of their arrival, be removed to the parish in which they had previously settled; and again in the subsequent legislation that permitted the establishment of workhouses.

Originally there was a certain justification for treating poverty in this narrow fashion, for the country was not as yet a complete economic unit, and distress in particular areas could, as often as not, be attributed to mainly local causes. But, with the industrial and commercial revolutions that took place in the eighteenth and nineteenth centuries, the roots of unemployment and poverty became more and more widespread. Distress might be inflicted upon one district on account of inventions that brought prosperity to another. A change in national habits might involve serious damage to a localised industry. As time went on, the reason might have to be sought in international rather than in internal rearrangements. Very little of the poverty that now besets us can be assigned to local circumstances, yet our public policy, despite important recent reforms, continues to over-emphasise local responsibility.

3. National and Local Revenues

§ 7. There is no fundamental difference between national taxation and local rating. Obviously the principles governing the revenues of London or Paris cannot be regarded as less important than those guiding the financiers of the minor nations. The term "local" is of relative significance. As Pro-

fessor Cannan has observed, "the real difficulty is not to find a local tax which is not a rate, but to find any tax which is not local. A New York State tax is local in relation to the United States, and . . . a true imperialist would regard insular imposts which we call 'imperial taxes' as local."[1]

When, however, we compare a local authority with the nation of which it constitutes a part, we find differences in their finances that are of considerable practical importance. First, there is the difference of degree. Secondly, there is the distinction, in this country especially, between the uniformity of national taxes and the variability of local rates. Thirdly, there is little in common in the manner of assessment. National taxes are uniform all over the country, but they are drawn from several sources. Local rates are variable, but they are all governed by the single criterion of immovable property.

§ 8. A distinction of another kind between the two modes of taxation arises from the different emphasis respectively placed upon the element of benefit in public finance. It was pointed out in the opening chapter that the conception of a national tax as a payment for a particular service was no longer generally maintained. In the first place, the huge scale of national services makes it difficult, if not impossible, to link up actual payment and benefit. Also, the cost of certain national services, such as defence against aggressors, cannot be split up according to the advantage conferred upon individuals. Further, even if the connection

[1] *History of Local Rates*, p. 4 (2nd edition).

could be traced, the extent to which it could serve as a basis of taxation must necessarily be limited. It would be foolish to suggest that for the benefits provided in the form of old age pensions, grants to the insurance funds, and so on, a specific tax should be levied upon the recipients.

In local finance the element of benefit is more pronounced. The area being more restricted, it is more possible for the ratepayers to identify particular payments with particular benefits. Some of the services, of course, are just as difficult to assign on a basis of individual contributions as are the services of the central authority. The expenditure of the local body on road construction and education, for example, does not give a calculable return to the ratepayer in exact proportion to the amount that he is required to pay. Many of the citizens gain no direct advantage at all, while others receive considerably more than they give. The well-to-do section of the community may not participate at all in the public educational facilities. Those who live in a residential district through which a new by-pass road has been constructed may lose heavily rather than gain. The citizens, as a whole, may be better off as a result, but particular sections may grumble that they individually are not getting value for their money.

§ 9. A different view has to be taken, of course, of those public services which are provided on a definite cost basis. The tramways, gas, electricity, and other undertakings are conducted more or less on commercial lines. Only that part, if any, of the revenue which represents a profit is

to be regarded as a local tax in the proper sense. The use of such terms as "water rate" is misleading. If, as is often the case, the cost of providing a supply of good water to an individual is greater than the "water rate" he is expected to pay, the expense of making good the deficit must be classed in a different category from the strictly commercial undertakings. Some municipalities in fact have contemplated extending the practice so as to supply milk at less than actual cost to the poorer classes of the community, especially to those who are rearing families. The ediate loss, so it is maintained, would be more than compensated by the improved physique of the children and their greater efficiency on becoming producers.

At the other end of the scale there are those public services which yield a handsome profit, and to that extent provide a relief to the rates. Opinion is divided on the propriety of charging such prices as will yield a large surplus for this purpose. No serious objection can be raised to the making of profits on services such as public markets and parking grounds. And local criticism, at any rate, is usually absent when most of the profit is made from visitors to the town. In a seaside resort, for example, all classes of ratepayers, rich and poor, have little scruple in benefiting from the profits on deck chairs and bathing huts. But such instances are not typical. Nearly the whole of the local profits, taking the country as a whole, is made out of the more common public services, and comes from the people who live, or have their business premises, on the spot.

The practice of appropriating profits on certain of

the public undertakings for the relief of the rates is criticised on grounds of equity. Much of the profit comes from the tramway and omnibus services, and the people who use these means of conveyance are mainly of the working classes. They live in small houses, and the relief to their rates is proportionately low. The more prosperous members of the community rarely have occasion to ride in the public vehicles, but, living in comparatively large residences, they enjoy a relief to their rates out of all proportion to the use they make of the service that has yielded the surplus. It is commonly contended, therefore, that the charges for such services should be no more than is sufficient to cover the actual cost, and that the absence of a profit, in such circumstances, should not be taken as an indication of inefficient administration.

CHAPTER XV

THE INCIDENCE OF LOCAL RATES

1. Special Problems

§ 1. National and local taxes, we have already had occasion to show, are subject to the same governing principles. Since, however, the respective tests of ability and the bases of assessment are so different, the problem of incidence has, beyond a certain point in the general argument, to be worked out on separate lines. The problem, too, is liable to present greater complications, because of the larger number of parties concerned. In national finance the task of tracing the money burden of a tax as between one class and another is comparatively straightforward. Either the impost falls on realised surpluses, in which case it usually remains at the point of impact, or it is levied upon particular acts or commodities, in which case the chief determining factors are considerations of supply and demand, to terms of which the majority of such problems can be reduced.

But in tracing the incidence of local rates we have to contend with a wider range of interests. The impact is, as a general rule, on the occupier of the land or building, and he, under favourable

conditions, may transmit part of the burden to the property owner, who, in turn, if circumstances permit, may shift it backward again to the landowner. Between the occupier and the building owner, or between the latter and the landowner, there may be leaseholders who do not escape altogether from the burden of the rates. Further, where the rated premises are used for business purposes, the shifting may take place in a forward direction, the burden resting ultimately on the consumers of the products.

§ 2. A second special difficulty in studying the incidence of local rates is presented by the circumstances peculiar to the sale and purchase of building property. Those commodities that are subject to customs and excise duties can, for the most part, be adjusted in supply fairly quickly to meet changed conditions of price and demand. The fact, too, that the demand for most goods of this class is elastic, as compared with the demand for land and buildings, gives added importance to the sensitiveness of the supply. To raise the price of an article may, by diminishing the demand, cause a prompt reaction in the supply and in unit costs of production. But things do not happen so quickly and automatically in the transmission of local rates. Contraction in the demand relative to supply, where this results at all, is a slow process; and where the demand, for various reasons, has increased at a greater rate than supply, the response of builders is by no means as immediate as that of producers of ordinary commodities. Frictional forces are, in fact, so pronounced that the normal tendencies for rates to

be shifted may become operative only after many years have elapsed. And in the meantime other forces, possibly in the opposite direction, may begin to operate, rendering the final position very difficult to estimate.

The problem is rendered more complicated by the fact that contracts in the property market are usually for a long period, and that changes in taxation that take place during the term of such contracts cannot fully express themselves until the property comes again into the market. There is, in addition, the expenditure involved each time agreements and leases are drawn up. This charge is more burdensome than in most other forms of exchange, and almost invariably adds to the comparative delay in transmitting the money burden of the rates to the final destination.

§ 3. The demand for business premises and dwelling-houses has several peculiarities. Once a tenant has committed himself to rent a dwelling or a factory, he cannot as a rule change over to an alternative building with the same ease as he can buy a new hat or change his dentist. Quite apart from the long-period contract to which he would ordinarily be committed, he would, in the event of an increase in the rates, find many difficulties in the way of moving his abode or place of business. A manufacturer or a trader who has built up a connection in a particular locality will make economies in every other direction before deciding to transfer his activities to another town. It may be that the cost of removal is so heavy, especially in the case of an industrial concern, that the

producers find it less disadvantageous to remain on the spot, even with the rates higher than in other parts of the country. Possibly there are facilities in the district, such as organised exchanges and special transport systems, which exercise a powerful restraining influence on the firms that might otherwise be inclined to move elsewhere.

The private resident has to contend with similar forces, though naturally on a lower scale. His lease is not usually drawn up for the same number of years, but he is liable to bear the brunt of any increase in the rates so long as the contract is in force. And even on its termination the chances are that the householder will seek a renewal and continue to bear the charge. For in his case, too, the cost of removal is a serious item, often involving a capital outlay which is more than equivalent to the increased rates on the house he is at present occupying.

§ 4. If these exceptional factors were not present, it would not matter very much whether the rates were levied directly upon the occupier, as is the general practice in this country, or whether they were collected from the owner, as is the method prevailing in some continental countries. For under such simple conditions the burden would soon be transmitted to its final destination, irrespective of the parties who first bore the impact. But in practice it matters a great deal whether the rates are imposed on the one party or on the other, for there is a distinct tendency for the money burden to stick, at least for a time, at the point of imposition.

If it is the intention that the occupier should bear the charge, there is, of course, no objection to the rate adhering in this fashion. It might indeed be regarded as one of the virtues of this form of taxation that one can make the burden remain where intended. So far as householders are concerned, there is in fact little cause for complaint, for it is the express intention of the legislature that the value of the property they occupy shall be taken as the basis of their ability to pay.

Though it be counted a virtue that the rates on the householder tend to remain where imposed, the tendency becomes irksome when applied to the industrialist and trader. For nobody can seriously maintain that the value of the premises they occupy is always a sound index of their ability to pay, or deny that they are perfectly justified in including the local imposts in their costs of production. Whether they can transmit the charge to their customers, by means of higher prices, is a problem we have still to consider.

§ 5. The task of tracing the incidence of local rates would be slightly less involved if it were possible to treat gross rentals as consisting of two definable parts, the pure ground rent and the actual building rent. This division was adopted by the earlier economists, and is also to be found in Marshall's *Principles*, where it is stated that "the rent of a house (or other building) is a composite rent, of which one part belongs to the site and the other to the buildings themselves".[1] But it is one thing to say that the gross rent is made

[1] *Principles of Economics*, p. 453 (8th edition); see also Appendix G in the same work.

up in this way, and quite another to maintain that the parts are separately calculable and that a certain proportion of the rates can be definitely ascribed to each of them.

Professor Seligman questions the validity of such a method. Referring to those economists who have sought to divide the rates into two parts, the one bearing on the site rent and the other on the building rent, and who, after computing the separate degrees of incidence, have combined them in a total at the end, he considers that such a method of procedure "seems inappropriate chiefly for the reason that we are seeking to combine what are essentially disparate things. The rent of the site is the net rent; but the rent of the house is the gross rent. To attempt to separate the entire rental paid for a house into the net rent of the land and the gross rent of the building is therefore as ill-advised as it would be, in discussing a tax on pianos, to divide it into two parts, one of which corresponds to the rent of the land which produced the raw material."[1] From this point of view, then, it is impracticable, for purposes of ordinary rating, to assess the site as distinct from the building. One cannot rent a building without at the same time renting the site on which it is based. Over a long period, and especially on occasions when a new lease is being negotiated, the separate estimates can usefully be attempted, but at any particular time it would be extremely difficult to divide with any accuracy the total rates into the component parts.

[1] *Shifting and Incidence of Taxation*, p. 300 (5th edition).

On the other hand, in dealing with a tax on the *selling* value of the building, it would be more expedient to treat the two elements separately. The purchaser may be exclusively concerned with the value of the site, regarding the existing building as something to be demolished and replaced. Or he may wish to obtain possession of the building for the special virtues it possesses. The value of the site on which it stands probably does affect the estimate of the value of the building, but there is no necessary connection between them. It may be generally concluded on this point that, in dealing with a tax on the selling value of property, it is helpful, so far as it is possible, to treat the site rent and building rent as separate entities, and to trace the incidence accordingly; but that, in considering the incidence of rates, it is unsound to divide the rental into the component elements.

2. Incidence on the Landowner

§ 6. It is unnecessary for us to enter at length into the share of local rates that is borne by the landowner, for the governing principles are essentially no different from those dealt with in the chapter on land taxes. It is sufficient to indicate the chief conclusions that were then reached. Land, it was shown, is a form of natural wealth, and its supply is incapable of increase, even though the pressure of the demand, due to growing population, is constantly becoming more intense. The result is that the rent may go up, independently of any effort of the landowner. The actual rent, it was

demonstrated, tends to be measured by the superiority of the better grades of land (whether in fertility or situation) over the marginal grades. Marginal land bears no true rent, and, as the price of the product is equivalent to the cost of production on the marginal land, it is evident that a tax imposed on such rent cannot be reflected in the form of increased prices. Thus, the common economic reasoning is in support of the contention that a tax or a rate on pure economic rent cannot be shifted, but must remain with the landowner. And if the impact, to begin with, should be on anybody else, the burden must eventually be transmitted to the owner of the land. Frictional forces, especially as manifested in long-period leases, may hinder the shifting, but sooner or later the rent-receiver must be saddled with most, if not the whole, of the charge.

§ 7. So runs the orthodox argument. Certain modifications, however, are necessary in connection with the shifting of local rates. To begin with, the ratio of pure rent to the total hire rental is usually smaller than is popularly imagined. Theoretically this should not make any difference so far as the element of pure rent is concerned, but in practice it may be very difficult to separate that element from the larger items of interest and profit. Where the proportion of pure rent happens to be high, some attempt can be made to analyse the several parts, and to tax accordingly. Even if the ratio is not determined with absolute accuracy, the results may justify the trouble. But, where the item for pure rent is of small amount, the cost of distinguishing it from the other factors may not be worth the yield.

In view of the small proportion, as a rule, of the net economic rent to the gross rental, and, further, of the difficulty of separating them with any accuracy, it may be generalised that a rate which is calculated mainly by reference to the aggregate value or rental is likely to be treated and borne as a whole. If it is shifted, there is little chance of its being broken up into different parts, one to remain with the occupier or be shifted forward to the consumer, and the other to be transmitted backward to the landowner. The tendency for the latter to bear the rate on pure rent is not denied, but as the rate is not specifically so assessed, and as the counter-tendencies for the rate on the other items to be shifted in a forward direction are much stronger, there is little to warrant the belief that the landowner bears a substantial proportion of the rate.

§ 8. The common theory that that portion of a tax which falls on economic rent cannot be shifted requires modification in still another way. So far in the argument we have ignored the possibility of a causal relationship between rent and rates. We have been discussing the tax and the thing taxed as if they could each be studied and estimated without reference to each other. But a moment's reflection will show that there is a close and even physical connection between rates and rent. Two plots of land in different localities may be the same in all respects and capable of use for identical purposes. But if the rates in the first area are higher than in the second, the net rent that the occupier in the second can afford to pay is less than in the first.

Rent, then, tends to decline where rates are high

and to rise where rates are low. Rent and rates come to be regarded as a whole, and an expansion or contraction in one of the constituent parts almost inevitably reacts on the size of the other. Here again the question of incidence broadens into one of effects. A heavy rate may in part be borne by the landowner, especially if the proportion of pure rent to total rental is high. But in the long run, if the high rates continue, the ability of the tenant to pay his share of the charges may diminish, and a portion of the burden may be transmitted to the landowner. This is not, however, an instance of mere shifting, for the heavy rates cause an indirect shrinkage in the amount of the economic rent. The landowner's income is reduced, not only by the rates he is required to pay, but by the contraction in the rent itself.

3. Incidence on the Building Owner

§ 9. If houses and business premises were like ordinary commodities, the incidence of local rates, so far as it concerned the building owners, would be an easy matter to determine. Even when the peculiar conditions attaching to this form of property are taken into account, there is no special difficulty in ascertaining the general position of the owner. Buildings, like most other goods, are increased in supply when they fetch high prices and are produced more slowly when prices are low. It is in this elementary but important way that they differ from land.

A rise or fall in local rates may temporarily affect the net return going to the building owner,

but eventually it must react upon the supply and therefore upon the price. If rates go up, and for the time being eat into the net revenue of the building owner, there is less inducement than before for new buildings to be erected, resulting ultimately in a shortage of premises, with a corresponding rise in rentals. If, on the contrary, a fall in rates involves a greater profit for the owner, a strong incentive is provided for new buildings to be erected, leading to a fall in rentals. Thus the rates must sooner or later be transmitted by the building owner, where he can be said to bear them at all, either backward to the landowner or forward to the occupier. They cannot, so long as building prices obey ordinary market conditions, remain for any considerable time on the owner.

§ 10. The time element, it will have been observed, is a very important factor in these discussions. In the long run a tax on buildings falls in the same way as a tax on anything else. But in the short period part of the tax may stick to the owner. The "long period" is purely a relative term. For some simply and easily produced articles ten weeks may be sufficient to permit of all the likely adjustments of supply and demand. For houses and factories ten years may not be enough to constitute the long period. They are more durable than most other goods, and new supplies represent but a small proportion of the total quantity in existence, thus having but a slow effect on rentals in general. The heavy cost of erection limits the supply of new buildings. A rise in the rental is not immediately followed by an increase in the rate of construction, nor by an appreci-

able falling-off in the demand. Until the time that the supply is again sufficient for normal requirements, the building owner may impose an additional toll on his tenants which may be likened to a scarcity rent.

§ 11. Within the limits of such a period, the reasoning now becomes similar to that applying to land and pure rent. On the assumption that the building owner takes full advantage of his opportunity and raises the rental to the utmost degree, he is in the same position as the landowner in our earlier example. If the rates are further raised he cannot make the tenants bear the charge, for they are already, according to our assumption, paying the most they can afford. Thus, to the extent that the rates fall on the "quasi-rent" of buildings, the burden cannot be shifted, but tends to remain with the owners.

Coupled with the comparative inelasticity of supply, in affecting the incidence of local rates, is the prevalence of long-period contracts. The building owner leases the land, on which the property stands, for a considerable number of years, and for the period of the lease he may be regarded to all intents and purposes as the owner of the land as well. That part of the rates which in the ordinary way would fall on the landowner now remains with the building owner. The latter takes the contingent liability into account when contracting for the lease, and where the rates are high the landowner may receive a lower rental in consequence. But the lessee cannot, as a rule, predict what is going to happen when many years have gone by. However astute

he may be, he cannot always foresee the trend of local developments and rates throughout a period of a long lease. During these years rates may soar or dwindle. The district may decline and become derelict. There may be a radical change in the system of national and local finance, involving a complete readjustment of the relative proportions. The inability, as a rule, to forecast the trend of rates in future years makes it impossible for the building owner to buy himself completely free of the liability.

§ 12. The position of the building owner has now for nearly a generation been modified to some extent by the Rent Restriction Acts. From one point of view he has had some cause for complaint, for although his expenses, both in his business and in his private life, have not been subjected to any public control, the rentals he is able to charge for a large proportion of his property are liable to State regulation, with the result that his expenditure has increased at a faster rate than his income. But that is not all. Though rents have been artificially kept down, rates have considerably increased. There is a natural tendency, as we have seen, for a tenant to regard his rental and rates as composing a single gross amount. The very fact that rates have gone up makes it more difficult in many cases for the house owner, even when partial or complete decontrol affords an opening, to raise the rent to the figure that he deems appropriate. The rent that he can charge is less than he would obtain if the rates were lower. Thus, although he does not actually pay the rates on his property, he does in effect bear part of the burden.

§ 13. The Rent Restriction Acts accentuate the conditions of the short period, though with the lapse of years their importance will diminish and the rates will tend to be distributed in accordance with the general principles already formulated. There is, however, another aspect of the time element which we have not yet touched upon, but which may appreciably affect the incidence in particular districts. As a general rule the supply of buildings, made up of old and of new properties, does not go much ahead of the demand, which tends steadily to increase. But the growth of the demand is not uniform, nor does it proceed at the same rate throughout the country. In some districts, especially those in which new industries are springing up, the demand for houses and other buildings quickly overtakes the supply, and the bargaining strength of the owners is increased in consequence. They are able to ensure not only the ordinary rental but a quasi-monopoly profit in addition. If they squeeze their tenants to the utmost extent, and then the rates are still further increased, it may be argued that the additional burden must be shifted backward to the owner. But the numerous counter-tendencies already enumerated would almost certainly retard such a redistribution of the burden.

§ 14. Consider, however, the conditions in a district in which the population is declining in numbers. Supply cannot be adjusted to demand with the same ease or rapidity as can the supply of ordinary articles. Buildings are consumed very slowly, and for a generation or more the supply may be so much in excess of the demand that the owners are compelled to let

their premises at sacrifice rentals. During this time the bargaining strength of the tenants is uppermost, and as a result they pay a rent that is less than normal. Were it not for the rates, the tenants might be willing to pay a larger rental, so that here again the owner is in reality making a contribution to the public funds.

Entire districts, in which these conditions prevail throughout, are normally rare, although at the present time, unfortunately, the number of apparently derelict areas is abnormally high. It is not unusual, however, to find at all times a rural area, or certain quarters of a town, in which the demand for houses has fallen more rapidly than the supply. The reason may be found in the migration of the population, a change in the industrial character of the locality, or the closing down of some of the large establishments there, or—in the residential districts—it may be simply a matter of fashion. It is evident from the above reasoning that the owner of occupied properties in a decaying neighbourhood is liable to bear part of the rates.

§ 15. Similar considerations apply where different scales of rates are imposed in areas which are adjacent to each other, and which, apart from the rate charges, are equally attractive. Provided that the advantages of the low-rated district are not neutralised by greater travelling or other expenses, there will naturally be a preference for the houses in that district. The relative decline in the demand for houses in the high-rated area may compel the property owners to reduce the rentals, and thus in effect undertake part of the rate burden themselves. On the

other hand, the increase in the demand for houses in the first area may result in the property owners raising the rentals, thereby lessening the net advantage that the district enjoyed in the matter of rates. Ultimately there may be little to choose between the aggregate sums that householders have to pay in the two localities.

4. Incidence on the Occupier

§ 16. The extent to which the occupier of industrial premises can shift the rate burden either backward or forward depends on several conditions. Only in rare circumstances can it be moved backward to the building owner or to the landowner. A forward shifting to the purchaser of his products is his main hope, and it can be accomplished principally when the demand is comparatively inelastic, and when the several firms in the industry, whether by specific agreement or not, pursue a common course. The inclusion of rates in production costs and therefore in the price of the articles is perfectly legitimate, but there is no certainty, even if other conditions are favourable, that each individual producer is able to recoup himself in this way. If the same poundage rate were levied throughout the country, it would be more practicable for the charge to be incorporated in the price, but, since the charge varies from one industrial area to another, the producers in the highly rated districts are often unable to shift the whole of the burden. Better to bear some of the charge themselves, they may argue, and keep their market, than to raise their prices,

and thus risk being undercut by firms that are situated in a district where rates are lower.[1]

§ 17. The ability of shopkeepers to shift their rates is governed by similar factors, though the relative importance of differential rates appears to be more in evidence. In the retail trade more than in manufacture a single firm is apt to have a number of branches, scattered perhaps over an area that shows a wide variety of poundage rates. A multiple concern may have shops in different towns, in which the rates vary by five shillings or more in the pound, yet sell its wares in the several establishments at a uniform price. That the aggregate rates paid by the firm normally enter into the price is not disputed. The high rates paid in one district may be set against the low rates in another, and uniform prices be settled accordingly. But there must be individual branches of which it can truly be said that a part of the rate charge tends to stick. In a town in which rates are low there may be a single store which effectively competes with the branch of the multiple concern. For the latter to charge prices that are in part determined by its relatively high average poundage rate would possibly render itself liable to be undersold by the store with a low rate charge. Even if the rates in a town containing one of the branches were to rise, and the costs of business firms there increased accordingly, it is unlikely that the prices charged by the multiple shop would be raised, unless the increase in rates occurred in several other localities

[1] The question of incidence in such cases becomes inseparable from that of effects. See below, pp. 306-307.

in which it rented premises. Further, any tendency for the multiple concern to raise its prices on account of its high average rates would probably be more than offset by the greater economies that it enjoyed over the individual rival shopkeeper. Its actual prices are, in fact, usually lower and not higher than those charged by the small dealer.

In retail selling, too, there has been a marked growth of recent years in the mail order business. Competition becomes more effective between the small town shopkeeper and the vast departmental stores in large cities, with the result that prices of an ever-increasing range of goods tend to become more uniform throughout the country. It is difficult to see how variations in local taxation can be reflected to any serious extent in differences in the scale of charges for such goods.

The actual incidence of the rates in industrial and commercial establishments is liable to be concealed by many factors. Rates constitute only one among many other costs, the proportion naturally varying with the character of the business. An increase in local taxation may have the effect of promoting economies in various directions, with the object of keeping down prices and retaining the share of the market. The directors may try to swell the turnover of the undertaking, so spreading the overhead charges and reducing unit costs. Among the numerous factors that go to determine the prices of the various goods sold, it is hardly practicable to gauge with accuracy the specific effect of the rates on prices, and therefore the exact nature of the incidence.

§ 18. We come finally to the incidence of rates on private dwelling-houses. Here the position is comparatively clear. There is, to repeat, a strong tendency for a tax to stick at or near the point of impact. The ordinary householder is seldom given the chance of shifting the burden. The act of selling provides the usual occasion, as a rule, for transmitting the charge, but for the householder, as distinct from the manufacturer or the trader, the opportunity is not often present.

The householder, then, cannot as a rule shift his rate burden in a forward direction. Can he transmit it backward to the building owner or, ultimately, to the landowner? Such a movement we have already shown to be rarely possible. Backward shifting is difficult at any time, and, in the absence of such opportunities as are occasionally offered to those engaged in trade, the householder must in the great majority of cases be content to bear the whole of the charge himself.

The more inelastic is the demand for houses (and the demand in general is distinctly inelastic), the more does the incidence of the rates tend to be on the occupier. This tendency is strengthened by the natural inertia of many people, the sentimental attachment to a particular house or locality, not to mention the possibly high cost of removal. A certain distinction, however, can be drawn between the burdens falling respectively on the occupiers of large and small dwellings. The working classes cannot afford to live at a great distance from their place of employment, and the pressure on the smaller houses to be found in or near the industrial parts

of the towns is correspondingly high Those with larger incomes are able, if they wish, to live at greater distances Not only may they enjoy a lower poundage rate in the districts in which they take up residence, but the fact that they have, as a rule, larger choice of localities puts them in a superior position, as compared with the working class population, in bargaining with the building owner But the advantage is in the aggregate only small, and there is little need to modify the generalisation that the incidence of rates on dwelling houses tends to be borne by the occupier The intention of the authors and administrators of the rating system that the burden should fall in this way is almost invariably fulfilled Thus, there would be cause for satisfaction, but for the doubtful criterion of ability that governs the entire scheme

CHAPTER XVI

LOCAL RATES AND INDUSTRY

I DEFICIENCIES OF THE PRESENT SYSTEM

§ 1 WE ended the previous chapter on a note of criticism of the principles at present governing the system of local rating Complaint is directed not only against the actual amount of the rates, but also against the selection of property in one's occupation as the criterion of ability to pay The defect is claimed to be too deep to be rectified by any measure which brings about only a surface adjustment of rates to the value of property

The force of this criticism shows itself in several different directions It is particularly evident, for example, if we compare the position of a man with a large family with that of a man with a small family, each living in houses of corresponding size If the income is the same in each case, the taxable capacity of the first man is obviously less than that of the second, but the rates are not calculated on such a basis As the system is at present devised, no allowance is made for the individual householder's outgoings, and the rate burden increases as the family grows

Where the incomes are different, the relative disparity of the rates is even more marked Suppose that one man has an income of £250, while another is in receipt of £1000 It is extremely unlikely, on the average, that the more prosperous of the two would occupy a house four times as large As one approaches the still higher levels of income, the proportion spent on house rent shows a further decline Thus, so long as local rates are based on rent, the burden falls with relatively greater severity on those with the smaller incomes

§ 2 In national taxation, the principle of progressive taxation is now accepted The scales of income tax, surtax, and death duties are steeply graduated, so that, the larger is the income or estate of a person, the greater is the percentage deducted by the Exchequer Excise and customs duties, it is true, are not capable of being graduated according to the position of the individual consumer Since the proportion expended on dutiable goods diminishes as one's income rises, the burden of the indirect duties works out in a regressive rather than a progressive manner As, however, only one third of our national revenues is obtained from commodity taxes, the heavy graduation of the direct scales is sufficient to give the system of taxation as a whole a marked progressive trend [1]

Local rates are open to the same criticism as indirect taxes But, while the weight of the commodity duties is in large measure rectified by the graduated direct duties, the unequal burden of the local rates is left unchecked As at present devised, the rates

[1] See above pp 78 80

must be regressive in character, and are therefore defective on the score of equity. Different, too, from income tax, they have to be paid whether a business is making a profit or a loss; and they are an element in costs, often to a damaging extent.

§ 3. The burden is unfairly apportioned, not only among householders of different degrees of income and family responsibility, but also among owners of different kinds of property. If it is right to tax property, there is no sound reason why land and buildings should be chosen as criteria while other forms of property are left out of account. Originally, once the property basis was decided upon, the choice of the actual basis was fairly obvious. Alternative forms of investment and expenditure were comparatively rare. The tax administrators were not far wrong when they estimated a person's capacity by reference to the extent of his property in the ordinary narrow sense. But in the course of time the manner and form of people's savings and expenditure underwent a change, and the occupation of premises no longer afforded a satisfactory measure of ability. One prosperous person might spend a fifth of his income on rent. Another, with the same income and number of dependants, but with different tastes, might devote only one-tenth to rent, and spend the balance on movable goods not subject to rates. The first man, under the present system, is hit more heavily than the second, simply because local taxation is restricted to a particular form of property.

The same discrepancy is to be found in the respective burdens of different kinds of industry, even

within the same rating district. An establishment which requires comparatively extensive premises and land is required to pay heavier rates than a concern which can be confined to a small space, although the profits of the two are no different. Thus, an iron and steel works may have a no greater volume of business than a boot factory, but the buildings and area are considerably greater. To tax the two undertakings on a similar basis is to inflict severe damage on the industry which, by its nature, is more dispersed.[1]

§ 4. Until now we have been considering the inequality of the rate burden as between different individuals and different types of business concerns in the same area. When we come to compare the burdens of undertakings in different localities, the inequality is found to be even more pronounced. A firm in one part of the country may be more efficient and turn out a better class of article than a rival firm in another district. If, however, the rates are much higher in the first than in the second area, the former concern may be seriously handicapped in competing for the market. Should the disparity continue, the firm that is adversely affected may consider the possibility of moving its establishment to another part of the country, even though several disadvantages may attend the change. There is the cost of dismantling and re-erection; transport costs may

[1] For instances of the proportion of rates to total costs reference may be made to the Reports of the Committee on Industry and Trade; in particular, *Factors in Industrial and Commercial Efficiency*, 1927 (pp. 59-62 and 473-92), and *Further Factors*, 1928 (pp. 106-8). Subsequent legislation, dealt with below, has to some extent eased the burden of industrial, as distinct from commercial, undertakings.

be greater; the new local labour supplies may not be so efficient; housing accommodation may not be adequate for transferred employees.

In the view of the firm itself the disadvantages of the new district may be outweighed by the smaller rates that will have to be paid—though there is no certainty that the local charges will not follow suit in the course of time. But a wider view may show that the change-over entails a net economic loss to the country in general. Labour and materials are possibly being diverted into less productive channels, and, although for the time being the decision may work out to the benefit of the concern, it does not necessarily follow that the community as a whole has gained. Hence the present methods of rating may prove to be not only inequitable in their incidence, but uneconomic in their effects.

2. The Reform of the Rating System

§ 5. By the Act of 1929 Parliament gave force to a measure for the reform of the rating system. The changes took three principal forms. First, it was decided to relieve to the extent of 75 per cent the rates on industrial premises; to grant a similar concession to the transport services, conditional upon their reducing the freight charges to agriculture and the "heavy" industries; and to remove entirely the rates on agricultural property. Secondly, in order to compensate the local authorities for the loss of revenue, it was decided to increase the national grants-in-aid, calculated according to specially devised formula. (The revenue from the newly im-

posed petrol duty was expected to provide most of the funds required for this purpose.) Thirdly, in order to reduce the difficulties and waste consequent upon the highly localised organisation of poor relief and road services, it was decided to transfer these functions from the smaller bodies to the county or county borough authorities.

§ 6. One criticism of the measure was that it relieved "industry" at the expense of other interests in the locality; or, as was popularly stated, that it merely robbed Peter to pay Paul. That, in the opinion of many critics, was a sufficient condemnation of the measure. But is it necessarily a bad thing to rob Peter to pay Paul? Have we not been doing this for centuries, both in our national and local finances? May not Peter be more able to bear the burden, or suffer less than Paul gains? State expenditure on social insurance, on old age pensions, on education, and so on, all entail a burden for certain bodies of taxpayers who receive back from the public authority nothing approaching the value of their compulsory contributions. Objection to the scheme merely on the ground that it increases the burden for some of the ratepayers does not carry much weight. It is the very essence of the scheme that the charge should be more equitably apportioned, and it is obviously impossible to give benefit to certain sections that are in relatively greater need of it without calling upon other sections to bear a bigger proportion.

The criticism, however, may be taken to refer to the increased national taxation to meet the reduced revenue from local taxation. The gain that accrues

to a person in his capacity as a local citizen, the argument runs, is offset by the heavier duties he is required to pay to the State. If the scheme worked out in this manner, there would, of course, be no general advantage. But is it correct to assume that this is what the scheme implies? In so far as the petrol duty is harmful to industry, there is much force in the contention that the gain to the industrialist is neutralised by the greater cost of fuel for transport. But the ratio of this burden to the benefit conferred by the reduction of local charges on industry is unlikely, except in a few industries, to be appreciable. The petrol duty does not, in fact, yield nearly enough to provide for the new contributions from the State in aid of local rates, and the national revenues in general have therefore to be drawn upon; but that does not weaken the case in the least for the redistribution of the burden. The selection of petrol as a medium for the new revenue is of secondary importance. What matters is that a national tax was chosen to act as a part-substitute for a local rate. Industrialists as a class have unquestionably to pay more to the central Exchequer than before, but it is very improbable that their additional liability on that account is anything approaching the extent to which their rates have been remitted. The submission, therefore, that the industrialist loses in one direction what he gains in another, will not, on this ground at any rate, bear serious examination.

§ 7. More serious is the criticism that the scheme rests on an artificial distinction between industry and trade. As viewed by the economist they are

complementary stages in the general scheme of production. The interdependence and inseparability need not be insisted upon if the scheme were an emergency one. But the decision to give relief to one section of production, largely at the expense of another section, hardly less important, for an indefinite period of years, cannot be accepted without question.

The argument put forward in defence of the differentiation is, of course, that industrial undertakings have, on the average, suffered more during recent years than commercial concerns. They have had to face severe foreign competition, whereas the distributive trades have enjoyed a "sheltered" position. Wholesale prices have dropped much more rapidly than retail prices. On grounds such as these the special measure of relief is defended. The possible inference, however, that the degree of profitableness is to be taken as the basis opens up fresh problems. If it is right to assist the coal and iron industry because their profits have shrunk almost to nothing, but to give no help to departmental and multiple stores because this kind of business has been comparatively flourishing, the question may be, and has been, asked whether it is right to reduce the rates of those industries that have not shared in the general slump but have, in fact, increased their profits. When the Bill was before Parliament there were many who wished to debar the brewing, tobacco, and artificial silk industries from the terms of relief.

§ 8. But, if this concession had been granted, the next demand might have been that the benefits

of rate remission should be withheld also from individual concerns, irrespective of the industry, that happened to be making relatively high profits. Even in the depressed industries there are firms that have been earning fairly good profits, and on the same principle the benefit might be kept back from them also.

If, however, this further differentiation were decided upon, the whole scheme would become so emasculated as to be in danger of collapse. What would be the dividing line between the industries to be assisted and those not to be assisted? What would be the standard of profits that determined whether a particular firm was to have some of its rates remitted or not? And, if it came to such a pass, why should there be a flat-rate remission of 75 per cent? Why should not those firms that were doing very badly get 100 per cent remission, while those firms making but a slender profit get only 25 per cent remission? There would be no end to the proposals that might be put forward, once the request for differentiation were acceded to.

The most serious objection, however, to any such disc · · ation between different industries and different concerns is that in many instances a penalty would, in effect, be placed upon efficiency and enterprise. If an industry is doing badly as a result of circumstances that are beyond its own powers of control, there is something to be said for public assistance. But some industries, and certainly many individual businesses, are suffering losses because of faulty organisation and antiquated pro-

cesses. If a "de-rating" scheme were carried to the extent of discriminating between different firms in a single industry, the results might be disastrous. A subsidy of any kind is open to many objections, but one that differentiated in favour of the less efficient deserves nothing but censure.

§ 9. One criticism of the scheme that has had a wide vogue is to the effect that, as the total amount involved was small to begin with, it would have been better to restrict the benefits to a few selected areas instead of spreading them thinly over the whole country. While certain comparatively prosperous localities enjoyed a small windfall, many of the depressed districts found the assistance too small to afford any real relief. Had the national grants been confined to the badly hit areas, it is maintained, the aggregate benefit to the country would have been greater, for, while the non-assisted areas would have carried on, those singled out for special help would have had a better chance of recovery. This proposed form of differentiation is in some ways less objectionable than that on a profits basis, but it is open to attack from other directions. As a measure for emergency assistance there is much to commend it, but to embody it in a permanent scheme would be obviously unsatisfactory.

§ 10. This leads us to the wider question of ultimate responsibility for the mitigation of hardship in particular localities, and to the provisions in the Local Government Act that transferred the poor relief and road services from the smaller authorities to the county or county borough councils. While this reform was unquestionably a step in the right

direction, it failed, in the opinion of many critics, to go far enough. The problem is really twofold. It is, on the one hand, a question of whether the *administration* should be left in the hands of a comparatively small authority. It is, on the other hand, a question of whether the *financial responsibility* should be left to the smaller area, or whether it should be undertaken by the nation as a whole.

The supersession of the Boards of Guardians by the Public Assistance Committees of the counties or county boroughs is generally agreed to have been beneficial. Under the former system there was multiplicity of duties and wasteful overlapping, while many of the smaller localities found themselves unable to cope with the distress concentrated within their boundaries. The supporters of the scheme in its amended form believed that the new area of administration was sufficiently large to secure efficiency and economy. They placed great emphasis upon the necessity for local supervision and for special knowledge of the district's needs.

To admit, however, that the larger local authorities are capable of successfully administering the poor relief services is not necessarily to agree with the financial apportionment of the burden. A whole county may be under the blight of trade depression, and the ratepayers may find increasing difficulty, through the vicious circle of high rates and unemployment, in facing the situation. Under such conditions the State must sooner or later intervene. Its decision to assume financial responsibility need not, if accompanied by adequate safeguards, interfere

with, or lessen the advantages of, local administration and supervision The principle is already accepted in the scheme of unemployment insurance, and to apply it to poor relief would be no revolutionary procedure

CHAPTER XVII

THE CONCENTRATION OF TAXATION

I THE TENDENCY TO CONCENTRATION AND SIMPLIFICATION

§ 1 A SURVEY of the history of public finance during the past hundred years clearly reveals the twofold tendency towards the concentration of the burden of taxation and the simplification of the methods of assessment and collection At times this tendency appears to have been in abeyance, or acting even in a reverse direction, but over the period as a whole it has been very marked A century ago almost the whole of our taxation was indirect in character, and was spread much more evenly over the population than would be possible or tolerated to day Though the rich paid larger sums than the poor, the proportions to their respective incomes were very unequal, rendering the system in general distinctly regressive The abolition of a large number of commodity duties, and the imposition and growth of the income tax, gradually improved the position, and subsequently, with the extension of the several allowances and abatements, and the institution of a surtax, the unequal distribution of the burden

was largely rectified In the last few years the taxes of this country have been still further concentrated, until now there is an outcry in some quarters against a system which, it is claimed, gives the masses of the people an increasing measure of political representation and power, but, apparently, a diminishing obligation to contribute to the public purse

Similarly the method of taxation has, on the whole, become very much simplified Commodity taxes that were at one time counted in hundreds fell in number by the beginning of the present century to less than a score The income tax and death duties proved a simpler and more direct means of revenue, and between them have come to be responsible for the bulk of the total yield The complexities of the income tax law and administration certainly need to be removed, but they are a small matter as compared with the cumbersome methods in vogue before direct taxation was introduced

§ 2 Though the motives have not always been the same, the concentration and the simplification of taxation have, for the most part, progressed together, and have been of mutual assistance When, for instance, the number of taxed commodities was successively reduced, and the loss in the revenue was made up by increases in the scales of income tax, the simplification of the collection almost inevitably led to a closer concentration of the burden Also, in some respects, the gradual concentration has aided in the simplification There is, for example, a strong case at the present time for the consolidation of the existing income tax and surtax, each with its own scale of progression, into one duty with a single

graduated scale. A similar, though less forceful, argument could be made out for the unification of the death duties, even if no new principle of graduation were introduced.

§ 3. During the last few years, however, the two movements have been less uniform. The distribution of taxation has maintained its tendency to further concentration, but the tendency to simplification has in some departments received a certain check, which may, or may not, be temporary. During the war and post-war years several new duties were created. In some instances, such as the entertainment and the petrol taxes, the purpose was entirely one of revenue. In others, such as the safeguarding duties, the motive was protectionist. It is difficult to avoid complications following the establishment of new taxes. If an import duty is deliberately designed to guard a home industry against foreign competition, there soon arise demands from non-protected industries for this kind of shelter, and it is difficult to draw the line. If, on the other hand, it is "for revenue only", care has to be taken to devise countervailing duties for home-produced commodities of a similar kind. One tax, whether protective or not, leads to another. If the use of substitutes causes the revenue from the taxed articles to be less than was anticipated, the substitutes have to be taxed as well. All kinds of trifling adjustments have to be made. Matches are taxed: therefore a duty has to be imposed on mechanical lighters, even though the additional revenue is negligible.

In local finance, too, the practice has become complicated rather than simplified during the past few

years. The system of local taxation and of national grants-in-aid badly needed overhauling and unifying. It was agreed by all parties, during the discussions prior to the Act of 1929, that the prevailing methods were not only antiquated, but extremely inequitable in their results. Industrial premises and agricultural property were therefore "de-rated", and a formula was devised for readjusting the grants from the central authority. But, whatever the virtues of the new arrangement, simplicity was not one of them. No sooner had the new scheme been published than modifications and provision for *ad hoc* adjustments were found to be necessary, with the result that the tangle became in some ways little better than before.

These new intricacies in our system of national and local taxation may be but temporary lapses. They will have served a useful purpose if they stimulate, by way of reaction, a renewed interest in the possibilities of simplification. From one point of view it seems not a little incongruous that a citizen should have to contribute towards the cost of the public services in such a variety of ways. It may be asked, in fact, whether it would be possible, not merely to reduce the at present large number of duties, but to obtain the entire revenue from a single graduated tax. In principle such a method would be highly desirable, and far more rational than the prevailing practice.

§ 4. The proposal, of course, is not new, though the suggested basis of such a tax has naturally changed with the times. As far back as the seventeenth century we find schemes for substituting a single impost in place of the many excises and customs. It was thought by early would-be reformers that a

single tax on luxury expenditure would be the ideal means. Although, strictly speaking, this method would have entailed a certain multiplicity of taxes, for there was no one luxury that could have been singled out to provide the whole of the revenue, the notion had at least the merit of simplicity. At a time when the needs of the State were very small, such a system of taxation might have provided sufficient funds, but it certainly would have been resisted by the well-to-do classes who naturally would have been the main purchasers of the luxuries subject to duty. Moreover, it would have discriminated unfairly between the moderately rich and the very rich, to the disadvantage of the former, since progressive graduation of commodity duties is impracticable to any serious extent.

Subsequently it was proposed to levy a single tax on property, taking either the rather narrow basis of houses and lands, or the wider basis of all material possessions capable of valuation and assessment. The limitations, however, of such schemes are soon evident, and we have only to look to our present system of local rating, which is a form of single taxing, to realise how unsatisfactorily the narrower method works out in practice. Even if the proposed tax were extended to all forms of property, the results would be little better. The failure of the American general property tax well illustrates the shortcomings of such a measure.

§ 5. Coming to more recent times we find the proposal of the Physiocrats and, later, of Henry George for a single tax on land values. We need not recapitulate the well-known argument that,

with the increasing pressure of a growing population on the limited supplies of land, the value is forced up independently of the owner's efforts, nor enter again into the economic proof that a tax on such surpluses cannot be shifted The question that now concerns us is, not whether *a* tax on land values is desirable, but whether a *single* tax on these values would be adequate to our needs To this question there is but one answer Though the land values of this country are considerable and are still in creasing, they are not nearly sufficient to provide the revenue that modern governments require Henry George had in mind the rapidly expanding land values in nineteenth century America, at a time when public expenditure was very small Nowadays, the growth of land values is much slower, while the financial needs of the State are much greater But, even supposing it were possible to secure all the needed revenue from such a tax, its equity would still be in doubt in that a large pro portion of the nation would escape from its due share of taxation Few would now carry their conviction, that the land is the source of all wealth and income, to the point of concentrating the entire charge on the landowners There is a strong case for the special taxation of surpluses, but it is a mistake to imagine that the land is the only, or in these days the chief, source of such increments

2 A Single Tax on Income

§ 6 Proposals for a single tax on incomes can be found very early in fiscal history—long before, in

fact, the income tax was adopted even as a minor agency of public revenue One notable plan, though not the first, was that put forward in 1707 by Vauban, a French minister, who recommended that all incomes, whether drawn from land and property, or from business, or from personal labour, should be subjected to a direct tax Small incomes were to pay 3 33 per cent, moderate incomes 6 66 per cent, and large incomes 10 per cent The State, it was submitted, should aim at raising in such a manner the bulk, if not the whole, of its revenue

Nearly a century and a half later (1848) Sparre, a German tax official, propounded a scheme for a direct income tax to take the place of the existing indirect duties Possibly he was influenced by the institution in England six years earlier of a small income tax Though there was little chance of the principle being nationally adopted, many other ardent reformers published their variants on the main scheme, and Ziegler, the mayor of Brandenburg, actually succeeded for a time in introducing a single progressive income tax in his own town [1]

Many schemes for the adoption of a single direct tax on incomes have made their appearance during the past fifty years, and the increasing concentration of the burden tends to give colour to the general proposal At the present time in this country, over two thirds of the public revenue comes from direct taxation—a remarkable change over from the position only a few decades ago A single income tax was admittedly difficult to accomplish in the days when even the ordinary income tax was either un-

[1] Seligman, *The Income Tax*, p 235 (2nd edition)

known or played but a small part in a multiple system, but nowadays, it is sometimes maintained, when people are more habituated to this form of taxation, the notion should not be so lightly dismissed as utopian. If the tendency to closer concentration and simplification is continued, and the ratio of direct taxation becomes still greater, the proposal for the complete substitution of a single direct impost for the existing method may well become a subject of practical politics.

§ 7. In principle there is much to be said in favour of a single graduated tax on incomes. It would, on the face of it, have the merit of simplicity. Since all taxes must, sooner or later, come from income, the direct imposition of the duty would short-circuit many of the existing methods of raising revenue, and would thus, it is claimed, be more expeditious and economical. Secondly, direct taxation is more adaptable and elastic than commodity duties, and could be more scientifically adjusted to the needs of the State. It sometimes happens that an increase in the tax on a commodity causes such a contraction of the demand that the financial yield is very disappointing to the Chancellor, quite apart from the detrimental economic effects on the industry concerned. Thus, in some respects, the proposed single income tax might be more certain in its yield than a composite scheme such as at present employed. Thirdly, it would possess the virtue of making every taxpayer know exactly what he hands over to the Treasury. The cynic may retort that, not only do many people prefer to be taxed in the dark, but that the State should keep the well-to-do

also in ignorance of the true amount of their contributions. But, though there may be some disappointment in store for those who advocate a universal income tax as a means of stimulating a sense of political and civic consciousness, the educative effect of direct as compared with indirect taxation cannot be gainsaid. Fourthly, direct taxation is much more capable of equitable adjustment to individual capacity to pay than commodity taxation possibly can be, and this capacity for progressive graduation is probably the weightiest argument of all. In so far as commodity duties are imposed on expensive luxuries, they aid rather than hinder the general scheme of progression, but, as they fall to a large extent on articles consumed by the masses of the population, their general character is distinctly regressive.

§ 8. The upholder of a multiple system of taxation does not deny the force of many of these arguments. He recognises the tendency to a closer concentration and simplification, which eventually may lead to what is virtually a single tax. But many years will have to elapse, he contends, before all indirect taxes can be scrapped. The ratio of direct to indirect taxation may have rapidly increased, but there is no adequate reason, now that it has reached two-thirds, for jumping the remainder and establishing a completely direct system.

The difficulties in the way of a single income tax are considerable. In the first place, the scheme is not so economical and simple as would appear on first examination. Because the cost of collecting the present income tax and surtax is only $1\frac{1}{2}$ per cent, as against 2 per cent or more in the case of many

commodity duties, it does not follow that the expense of raising the whole of the revenue on an income basis would be equally low. The reason for the present low cost of collection is to be found in the high average duty that is imposed. Exacting £1000 in income tax and surtax from one taxpayer does not cost a great deal more than collecting £100 from another—certainly not ten times as much. But if the range of incomes liable to income tax were lowered, the average of the sums raised would naturally diminish, and the ratio of the cost of collection would almost inevitably increase.

A system of collecting income tax from wage earners in the form of stamps, affixed to a card in the manner of insurance contributions, has its attractions, but it is not quite so simple as it sounds. To make an equitable adjustment of the tax as between one set of wage-income receivers and another, it would be necessary to have a varied scale of duties, for obviously a flat rate of duty would hit the man with a low wage more heavily than a man with a high wage. Then there would be the difficulty of making allowances for irregular earnings and for weeks of unemployment, and also for children and adult dependants, not to mention the several other charges on income normally permitted. The existing scheme of commodity taxation is open to many objections, but there would be little to be gained in practice from the proposed innovation unless the new method showed a clear advantage over the old.

It must be borne in mind that the growth in the ratio of direct taxation, and the liability to a still further increase, does not necessarily entail a reduc-

tion in the number of duties. Though indirect taxation has declined in proportion, it has increased considerably in its yield. Further, there is a certain multiplicity even in the system of direct taxation. The income tax, as at present devised, is in some respects a composite tax, the five schedules covering different sources of income. The inheritance duties, too, have an important place in direct taxation, though it is best to regard them as complementary to, and in some ways as checking the deficiencies of, the income tax rather than as perfectly independent duties.

§ 9. There are few supporters of a single tax who would interpret the principle so rigidly as to exclude duties on inheritances. To abolish the death duties would mean a considerable falling-off in the revenue, and to attempt to make good the deficiency by raising the income tax would be liable to have harmful economic effects. Also, the narrow interpretation of a single income tax so as to exclude the death duties would not appeal to those who regard the system of inheritance as an important contributory cause of inequality, and who would use those duties largely with the object of reducing the disparities in income and wealth.

To rebut the charge of inconsistency the single taxer might contend that the death duties were nothing more than a form of deferred income tax. Or he might propose that inheritances should, as they are received, be treated as income, and be taxed accordingly. But there should be no need to resort to such interpretations or expedients if the essential principle of unity were properly grasped. The death

duties, though they are technically independent means of revenue, are very intimately bound up with the income tax and form an integral part of the whole scheme of direct taxation. If it were possible to abolish all indirect duties, and to concentrate entirely on the income and inheritance taxes, the system would be as "single" in its aim and method as the most optimistic advocate could expect.

§ 10. Until the scheme of public finance is so developed that it is possible to estimate everybody's capacity to pay, and to impose a direct tax in such a way that it cannot be avoided or shifted, there will be a case for retaining, within limits, a multiple system of taxation. The several taxes that we now have serve in some measure as mutual correctives, and spread over a wider field than a single tax, at the present time, could possibly cover. The death duties, we have seen, make up for some of the deficiencies of the income tax. The excise and customs duties enable the State to reach many people, whom it is either impossible to tax directly, or whose contributions are so small that the cost of collection in any other way would be very heavy. The duties on luxuries not only bring in revenue, but they also have salutary effects on consumption, and ultimately perhaps on production. Further, whatever the defects of our system of local taxation—and we have observed how considerable they are—there are few who would propose that the whole of the local rates should be merged in a national income tax. Such arguments may not all have the same force, but in the aggregate they furnish a case for a moderate multiple system that the exponents of a

complete single tax, in the present stage of development, find it difficult to controvert

Nevertheless, the ideal of a single tax on income ought not to be lost sight of That people should contribute to the State in such a wide variety of ways on perhaps every day of the year is hardly the most rational method The convenience of the prevailing system is an attractive feature, but it may be dearly bought A single income tax need not, if properly devised, impose a greater hardship, and if the people were made more conscious than they are now of the amount of their actual tax payments, that would be an advantage rather than a loss The day has gone by when the perfect system of taxation was regarded as pressing lightly on many points and heavily on none The concentration and simplification of taxation has fast developed during the past hundred years, and, though even a modified single tax on incomes is not yet in sight, we may be nearer to it than we imagine

STATISTICAL APPENDIX[1]

TABLE I

TOTAL REVENUE AND EXPENDITURE OF THE UNITED KINGDOM

1912–13 TO 1929–30

Financial Year	Revenue	Expenditure
1912–13	£188,802,000	£188,622,000
1913–14	198,243,000	197,493,000
1914–15	226,694,000	560,474,000
1915–16	336,767,000	1,559,158,000
1916–17	573,428,000	2,198,113,000
1917–18	707,235,000	2,696,221,000
1918–19	889,021,000	2,579,301,000
1919–20	1,339,571,000	1,665,773,000
1920–21	1,425,985,000	1,195,428,000
1921–22	1,124,880,000	1,079,187,000
1922–23	914,012,000	812,496,000
1923–24	837,169,000	788,840,000
1924–25	799,436,000	795,777,000
1925–26	812,062,000	826,100,000
1926–27	805,701,000	842,395,000
1927–28	842,824,000	838,585,000
1928–29	836,435,000	818,041,000
1929–30	814,971,000	829,494,000

[1] The statistics in this Appendix are reproduced by permission of the Controller of H M. Stationery Office

Heads of Revenue and Articles.		1913–14.	1918–19.	1919–20.	1920–21.
		Thousand £.			
INCOME TAX AND SURTAX:					
Schedule A		10,804	21,900	44,500	340,665 (A to E)
" B		214	4,820	7,000	
" C		2,867	19,700	22,000	
" D		27,294	155,645	209,829	
" E		[illegible]	25,640	32,800	
Surtax		3,339	35,560	42,405	55,669
Total Income Tax and Surtax		47,241	283,258	359,434	395,334
EXCESS PROFITS DUTY and Munitions Levy		..	283,977	289,208	218,099
CORPORATION PROFITS TAX		..	..	..	701
ESTATE, ETC., DUTIES:					
Probate Duty, including Temporary Estate Duty		67	20	14	19
Estate Duty, 1894		21,649	25,144	36,638	40,614
Legacy, Succession and Corporation Duties		5,449	5,636	6,108	6,545
Total Estate, etc., Duties		27,165	30,800	42,760	47,181
STAMP DUTIES:					
Land and Property, other than Stocks and Shares		1,856	2,530	5,768	6,590
Stocks, Shares, Debentures, etc.		3,164	2,551	6,119	4,064
Companies' Share Capital Duty		705	1,025	3,694	5,950
Cheques, Bills of Exchange, etc.		2,451	4,384	4,917	5,545
Receipts, etc.		715	717	709	1,239
Shipping		309	554	741	1,010
Certificates and Licences		175	155	162	161
Insurance and Miscellaneous		508	458	726	789
Total Stamp Duties		9,883	12,417	22,891	25,541
LAND TAX		690	648	671	650
LAND VALUES DUTIES		735	710	651	306
INHABITED HOUSE DUTY		1,934	1,860	1,905	1,956
MOTOR VEHICLE DUTIES		..	..	..	7,775
CUSTOMS AND EXCISE:					
Spirits, Imported	*Customs*	4,485	5,579	16,169	17,127
" Home Made	*Excise*	19,540	18,663	42,634	53,908
Total Spirits		23,975	24,242	58,803	71,035
Beer Imported	*Customs*	32	..	2	12
" Home Made	*Excise*	18,623	25,423	71,276	123,394
Total Beer		18,655	25,423	71,278	123,406
Wine	*Customs*	1,152	1,409	2,235	2,918
Sweets (British Wine)	*Excise*	..	..	..	..
Table Waters and Cider: Imported	*Customs*	..	5	11	16
" Home Made	*Excise*	..	1,582	1,421	1,265
Total Table Waters, etc.		..	1,587	1,432	1,281
Tea	*Customs*	6,499	16,055	17,747	16,861
Cocoa	*Customs*	341	2,483	2,474	1,795
Coffee	*Customs*	178	712	621	567
Chicory, Imported	*Customs*	43	56	58	84
" Home Grown	*Excise*	1	12	17	4
Total Chicory		44	68	75	88

II

PRINCIPAL HEADS OF REVENUE

KINGDOM

1921–22.	1922–23.	1923–24.	1924–25.	1925–26.	1926–27.	1927–28	1928–29.	1929–36.
Thousand £.								
334,934	814,375	271,433	275,456	258,065	230,136	253,465	237,274	237,876
61,351	63,916	61,747	62,989	67,833	66,295	60,653	56,214	56,624
396,285	378,285	333,186	335,445	325,898	296,431	313,548	295,488	294,497
29,671	1,122	1,868	2,758	2,383	4,584	295	1,196	1,694
17,764	13,815	23,451	18,005	11,705	3,875	1,789	817	645
18	13	18	13	10	20	11	8	16
45,146	48,463	49,805	50,514	52,861	59,085	68,621	72,232	59,546
7,357	8,018	7,764	8,696	8,459	8,325	8,469	8,781	9,676
52,521	55,494	57,557	58,917	61,330	67,432	77,101	81,021	79,234
4,645	4,111	4,161	4,575	4,660	4,602	4,857	4,855	4,849
4,594	7,175	5,755	7,102	8,499	7,984	9,820	11,695	7,270
2,156	1,855	2,295	2,225	2,680	3,565	3,250	4,416	5,771
4,528	4,472	4,750	5,182	5,508	4,772	4,977	5,123	4,867
2,300	2,767	2,121	2,185	2,277	2,658	2,284	2,280	2,685
774	617	631	571	678	643	666	664	685
155	152	155	155	155	155	149	159	156
725	702	730	718	817	850	884	955	999
19,577	21,851	21,579	22,758	25,129	24,870	25,594	30,134	25,255
577	646	618	722	673	632	624	523	636
450	217	299	252	262	216	261	216	249
1,943	2,070	1,900	491	23	8	4	1	..
11,651	12,584	14,628	15,465	18,456	21,529	24,739	25,535	26,598
11,541	8,559	8,893	8,229	7,938	6,494	6,799	6,670	5,948
51,278	45,679	45,144	42,825	41,990	67,659	46,568	88,998	86,651
62,519	53,648	54,057	51,054	49,928	43,553	47,667	45,668	42,599
20	35	5,591	6,162	6,083	5,433	5,518	4,978	5,896
121,845	92,263	76,111	75,826	76,320	78,763	77,861	76,847	71,255
121,865	92,298	81,762	81,988	82,403	84,196	83,319	75,825	77,151
2,751	3,052	3,369	3,752	3,746	4,329	4,149	4,248	4,881
..	..	..	..	..	..	119	202	216
16	24	26	36	32	32	35	36	46
1,247	981	714	518	383	869	852	855	359
1,263	1,665	746	548	415	461	387	891	899
17,582	11,556	16,731	5,971	5,780	5,958	5,751	5,740	46
1,865	1,290	1,258	669	735	754	697	709	689
597	416	461	212	204	206	204	198	198
86	67	88	37	43	42	42	44	64
5	4	2	1	1,	1	..	..	..
91	71	90	38	44	43	42	44	34?

TABLE II

NET RECEIPTS FROM

UNITED

Heads of Revenue and Articles.		1913–14	1918–19.	1919–20.	1920–21.
		Thousand £.			
CUSTOMS AND EXCISE—(*continued*)					
Sugar, Molasses, etc.	*Customs*	3,272	27,007	40,888	29,370
	Excise	56	1,091	1,157	1,075
Total Sugar		3,328	28,096	42,045	30,445
Dried Fruits	*Customs*	514	281	1,054	696
Tobacco, Imported	*Customs*	18,264	46,231	60,858	55,521
" Home Grown	*Excise*	20	61	13	11
Total Tobacco		18,284	46,292	60,871	55,532
Matches and Mechanical Lighters: Imported	*Customs*	..	321	1,086	695
" Home Made	*Excise*	..	1,706	2,312	2,156
Total Matches, etc.		..	2,027	3,398	3,051
Motor Spirit, Imported	*Customs*	823	2,154	2,991	2,559
" Home Made	*Excise*	18	68	10	..
Total Motor Spirit		841	2,222	6,001	2,559
Cinematograph Films	*Customs*	..	170	209	214
Clocks and Watches	*Customs*	..	664	919	781
Motor Cars, Motor Cycles, etc.	*Customs*	..	191	1,996	4,050
Musical Instruments	*Customs*	..	59	237	435
Silk and Artificial Silk	*Customs*	..	..	..	..
Artificial Silk	*Excise*	..	..	..	..
Total Silk		..	..	..	..
Hydrocarbon Oils	*Customs*	..	..	..	..
	Excise	..	..	..	..
Total Hydrocarbon Oils		..	..	..	..
Entertainments	*Excise*	..	7,520	10,479	11,736
Liquor Licences	*Excise*	4,496	1,256	1,467	3,878
" (Monopoly Value)	*Excise*	21	17	31	49
Other Licences	*Excise*	1,201	1,105	1,580	1,096
Railway Duty	*Excise*	288	3	8	8
Medicines (Stamp Duty)	*Excise*	360	1,066	1,333	1,869
Betting Duty	*Excise*	..	..	..	..
Hops	*Customs*	..	..	..	..
Key Industry Duty—Goods subject to	*Customs*	..	..	..	..
Depreciated Currency Duty—Goods subject to	*Customs*	..	..	..	..
Lace and Embroidery	*Customs*	..	..	..	..
Cutlery	*Customs*	..	..	..	..
Gloves	*Customs*	..	..	..	..
Mantles for Incandescent Lighting	*Customs*	..	..	..	..
Paper, Packing or Wrapping	*Customs*	..	..	..	..
Pottery, Translucent or Vitrified	*Customs*	..	..	..	..
Buttons	*Customs*	..	..	..	..
Hollow ware: Wrought enamelled	*Customs*	..	..	..	..
Other Articles and Deposits	*Customs*	16	89	1	44
	Excise	34	90	44	19
Total Revenue	*Customs*	35,569	103,466	149,554	133,850
	Excise	39,658	59,663	133,782	199,963
Total Customs and Excise		75,227	163,129	283,336	333,813

(continued)

PRINCIPAL HEADS OF REVENUE

KINGDOM

1921–22.	1922–23	1923–24.	1924–25.	1925–26.	1926–27.	1927–28.	1928–29.	1929–30.
Thousand £.								
35,947	39,376	37,127	20,035	18,394	17,429	17,039	13,912	11,753
813	812	990	497	976	1,354	1,703	1,376	1,796
35,760	40,188	38,117	20,532	19,370	18,783	18,742	15,288	13,549
773	841	928	731	565	588	615	643	475
55,198	53,391	51,881	51,909	53,494	53,857	58,102	59,086	62,793
11	5	1	3	4	2	2	1	1
55,209	53,396	51,882	51,912	53,498	53,859	58,104	59,087	62,794
1,101	1,213	1,335	1,532	1,711	2,123	2,209	2,077	2,160
2,122	1,800	1,786	1,763	1,634	1,456	1,745	1,883	2,010
3,223	3,013	3,121	3,295	3,345	3,579	3,954	3,960	4,170
169	..	..	..	..	..	..	..	..
..	..	..	..	..	..	..	..	..
169	..	..	..	..	..	..	..	..
254	271	289	42	103	223	215	192	295
450	538	542	48	179	417	559	614	584
764	1,271	1,436	107	661	1,834	2,549	2,470	2,406
230	347	323	9	188	238	240	239	407
..	..	..	..	2,591	4,960	4,767	4,597	4,592
..	..	..	..	608	707	1,225	1,466	1,650
.	..	..	..	3,199	5,667	5,992	6,063	6,242
..	..	.	..	..	..	..	9,364	15,043
..	..	..	..	..	..	..	3,618	..
..	..	..	..	..	..	..	12,982	15,043
10,280	9,603	9,285	6,249	5,714	5,729	6,120	6,004	6,696
4,530	4,145	4,245	4,588	4,484	4,413	4,514	4,433	4,452
35	42	62	70	70	84	110	187	125
487	465	468	457	470	455	510	531	531
191	493	450	427	414	388	375	357	52
1,828	1,219	1,307	1,328	1,290	1,295	1,250	1,334	1,234
..	..	..	..	..	835	2,669	2,245	286
..	..	..	..	117	174	817	290	205
140	336	353	451	462	505	633	633	771
..	231	248	26	1	..	..	..	..
..	..	..	..	175	221	215	231	282
..	..	..	..	15	77	110	101	107
..	..	..	..	94	608	579	584	434
..	..	..	..	4	11	7	3	3
..	..	..	..	..	495	525	552	570
..	..	..	..	..	..	78	56	61
..	..	..	..	..	..	..	128	145
..	..	..	..	..	..	..	45	57
6	52	4,845	24	19	13	31	582	262
43	50	7,162	518	118	51	126	47	53
129,140	122,772	120,004	99,832	103,282	107,016	111,948	118,975	120,611
194,215	156,961	147,727	135,175	134,476	132,972	139,190	133,844	127,371
323,355	279,733	267,731	235,007	237,758	239,988	251,138	252,819	247,982

TABLE III

IMPERIAL EXPENDITURE (EXCHEQUER ISSUES) OF THE UNITED KINGDOM UNDER THE PRINCIPAL HEADS

	1913–14.	1918–19.	1919–20.	1920–21.	1921–22.	1922–23.
I. CONSOLIDATED FUND SERVICES	£	£	£	£	£	£
Inside the Permanent or Fixed Annual Charge	24,500,000	23,038,003	23,773,052	24,500,000	24,500,000	14,200,421
Outside the Permanent or Fixed Annual Charge	..	246,326,557	308,260,056	325,098,010	307,794,347	309,780,511
Total National Debt Services . .	24,500,000	269,364,050	332,033,708	349,598,616	332,294,347	323,980,932
Road Fund	1,304,051	..	..	8,930,080	10,705,000	11,772,043
Payments to Local Taxation Accounts, etc.	9,734,128	9,680,812	10,740,142	10,780,503	11,171,710	10,471,010
Payments to Northern Ireland Exchequer	..	..	..	..	1,103,303	3,322,930
Land Settlement	..	..	8,477,447	6,020,703	2,647,009	1,235,874
Other Consolidated Fund Services:						
Civil List	470,000	470,000	470,000	470,000	470,000	470,000
Annuities and Pensions . .	316,570	338,331	339,565	347,143	350,054	300,457
Salaries and Allowances . .	50,547	55,801	50,038	50,323	57,803	53,974
Courts of Justice . . .	533,042	521,353	527,150	533,780	531,070	530,200
Miscellaneous Services . .	317,725	313,831	554,800	309,021	440,200	1,278,103
Total . . .	1,693,890	1,009,400	1,947,031	1,700,279	1,868,102	2,704,809
Total Consolidated Fund Services (carried forward)	37,322,069	281,344,868	348,204,028	378,040,877	359,878,927	353,490,004

	1923–24	1924–25	1925–26	1926–27	1927 28	1928–29	1929–30
I CONSOLIDATED FUND SERVICES (continued)	£	£	£	£	£	£	£
Total National Debt Services	347 368 748	357 161 261	358,229 246	378,583 679	378 815,287	369 066 666	355 006 000
Road Fund	14 000 044	15 563 044	17,455 044	17 873 100	10 665 586	21 136 633	21 881 532
Payments to Local Taxation Accounts etc	13 662 031	13 967 146	14 468 550	14 172 075	15 366 445	15 262 044	13 314 453
Payments to Northern Ireland Exchequer	3 666 865	3 821 660	4 860 814	5 705 752	5 277 260	5 100 410	5 525 004
Land Settlement	1 200 128	603 362	770 546				
Other Consolidated Fund Services							
Civil List	470 000	470 000	470 600	470 060	470 000	470 000	470 600
Annuities and Pensions	380 263	473 167	430 350	370 706	387 800	401 878	412,055
Salaries and Allowances	42 386	41 820	41 841	41 658	32 104	21 132	21 135
Courts of Justice	515 170	481 763	473 610	475 807	471 842	475 005	485 880
Miscellaneous Services	1 385 967	1 013 488	955 408	1 506 060	2,205 017	1 438 523	1 621 584
Total	2 802 706	2 430 238	2 371 569	2 860 331	3 550 753	2 866 538	3 311 554
Total Consolidated Fund Services (carried forward)	383 040 211	393 606 711	396 149 778	418 765 627	422 785 341	413,240,525	399 033 543

TABLE III (*continued*)

IMPERIAL EXPENDITURE (EXCHEQUER ISSUES) OF THE UNITED KINGDOM UNDER THE PRINCIPAL HEADS

	1913–14.	1918–19.	1919–20.	1920–21.	1921–22.	1922–23.
	£	£	£	£	£	£
Total Consolidated Fund Services (*brought forward*)	37,322,909	281,344,868	348,204,928	378,040,877	350,879,027	353,400,004
II. Supply Services						
Army	28,340,000	15,010	395,000,000	181,500,000	95,110,000	45,400,000
Ministry of Munitions	..	1,300	..	..	..	..
Navy	48,833,000	17,010	156,528,000	88,428,000	80,770,000	50,200,000
Air Force	..	7,000	52,500,000	22,300,000	13,500,000	9,400,000
Civil Services:						
I. Central Government and Finance	802,940	3,118,806	2,017,372	2,108,145	2,182,000	2,015,404
II. Imperial and Foreign	1,557,255	1,235,035	4,294,425	7,538,263	34,572,510	13,900,307
III. Home Department, Law and Justice	2,875,915	4,667,502	10,571,417	12,020,400	13,882,878	11,005,200
IV. Education	17,400,094	22,870,253	30,112,167	54,046,802	50,448,940	49,555,575
V. Health, Labour, and Insurance	13,804,509	14,530,334	78,700,800	72,538,388	72,881,705	61,034,170
VI. Trade and Industry	1,230,416	2,375,887	7,006,505	13,472,320	11,091,074	4,860,440
VII. Common Services (works, stationery, etc.)	4,230,022	4,807,833	14,350,030	10,745,580	14,004,148	7,833,353
VIII. Non-effective Services (Pensions)	701,275	769,330	100,403,377	110,298,080	95,831,315	82,025,873
IX. Miscellaneous (Expiring Services)	..	1,100	60,427,813	30,230,807	80,241,120	30,500,354
X. Exchequer Contributions to Local Revenues, etc.	..	..	..	..	..	..
Votes obsolete in 1927–28	11,135,914	13,011,914	256,950,314	131,247,001	57,003,203	15,875,072
Total Civil Services	53,901,000	67,988,000	509,054,000	460,210,000	449,700,000	280,820,000
Customs and Excise	2,431,000	2,502,000	4,902,000	4,010,000	9,750,000	4,880,000
Inland Revenue	2,052,000	2,970,000	4,430,000	9,040,000	7,440,000	9,437,000
Post Office Services	24,607,000	26,390,000	48,064,000	53,078,000	95,077,000	49,857,000
Total Supply Services	160,170,000	99,956,320	1,230,568,000	817,381,000	719,307,000	459,000,000
Votes of Credit—Naval and Military Operations, etc.	..	2,198,000,000	87,000,000	..	..	..
Total Expenditure chargeable against Revenue	197,492,969	2,579,301,188	1,665,772,928	1,195,427,877	1,079,166,627	812,496,604

	1923–24	1924–25.	1925–26.	1926–27.	1927–28.	1928–29.	1929–30.
Total Consolidated Fund Services *(brought forward)*	£ 383,040,211	£ 393,000,711	£ 398,140,778	£ 418,700,027	£ 422,785,341	£ 413,240,525	£ 390,033,043
II. SUPPLY SERVICES *(continued)*							
Army	43,000,000	44,765,000	44,200,000	43,000,000	44,150,000	40,500,000	40,500,000
Ministry of Munitions . . .	..	..	..	..	..	..	..
Navy	02,000,000	00,625,000	50,657,000	57,000,000	58,140,000	50,920,000	00,750,000
Air Force	0,000,000	14,310,000	10,470,000	10,030,000	10,150,000	10,050,000	16,750,000
Civil Services :							
I. Central Government and Finance	2,837,722	2,312,761	2,493,818	2,153,427	1,992,732	2,038,000	2,000,078
II. Imperial and Foreign . .	10,171,016	8,109,172	8,870,187	8,913,913	7,681,278	5,079,887	0,470,810
III. Home Department, Law, and Justice	11,301,070	11,419,959	12,221,432	12,532,592	12,025,107	12,123,423	12,358,072
IV. Education	47,404,901	48,352,201	48,100,838	52,783,380	53,257,784	40,450,346	50,060,587
V. Health, Labour, and Insurance .	59,304,204	64,510,720	65,217,828	74,550,452	72,807,105	75,005,004	85,763,405
VI. Trade and Industry . .	7,400,001	4,411,974	6,573,040	8,543,294	9,947,600	0,145,144	10,415,000
VII. Common Services (works, stationery, etc.)	7,516,273	8,320,460	8,938,482	8,450,208	8,488,104	8,230,400	7,073,205
VIII. Non-effective Services (Pensions)	71,504,326	71,270,477	70,355,801	65,821,784	62,290,041	58,001,830	66,184,805
IX. Miscellaneous (Expiring Services)	1,895,844	485,947	20,142,154	6,770,050	905,149	1,303,263	909,418
X. Exchequer Contributions to Local Revenues, etc.	..	..	..	..	..	..	15,294,096
Votes obsolete in 1927–28 . .	10,809,343	6,921,320	1,250,311	7,000	..	..	..
Total Civil Services . .	230,306,000	226,134,000	243,263,000	240,486,000	229,815,000	222,403,000	245,035,000
Customs and Excise . . .	4,780,000	4,640,000	4,770,000	4,800,000	4,850,000	4,805,000	4,045,000
Inland Revenue	0,043,000	6,316,000	0,090,000	6,054,000	0,805,000	0,782,000	7,080,000
Post Office Services . . .	49,811,000	60,380,000	58,050,000	64,900,000	50,800,000	57,200,000	58,900,000
Total Supply Services . .	405,800,000	402,170,000	427,950,000	423,580,000	415,800,000	404,800,000	430,460,000
Votes of Credit—Naval and Military Operations, etc.	..	..	..	.	..	..	..
Total Expenditure chargeable against Revenue	788,840,211	795,776,711	826,000,778	842,396,027	838,685,341	818,040,525	829,493,543

TABLE IV

REVENUE AND EXPENDITURE OF THE UNITED KINGDOM

1929–30

Ordinary Revenue		Ordinary Expenditure	
INLAND REVENUE	£	CONSOLIDATED FUND SERVICES	£
Income Tax	237,426,000		
Surtax, including arrears of Super-Tax	56,390,000	Interest and Management of National Debt	307,252,000
Estate Duties	79,770,000		
Stamps	25,670,000		
Excess Profits Duty and Corporation Profits Tax	2,250,000	Payments to Local Taxation Accounts	13,314,000
		Payments to Northern Ireland Exchequer	5,526,000
Land Tax, etc.	880,000	Other Consolidated Fund Services	3,312,000
	402,386,000		
CUSTOMS AND EXCISE		Total	329,404,000
Customs	119,888,000		
Excise	127,500,000	SUPPLY SERVICES	
	247,388,000	Army Votes (including Ordnance Factories)	40,500,000
MOTOR VEHICLE DUTY		Navy Votes	55,750,000
Exchequer Share	4,920,000	Air Votes	16,750,000
		Civil Votes	246,535,000
TOTAL RECEIPTS FROM TAXES	654,694,000	Customs and Excise and Inland Revenue Votes	12,025,000
Post Office Net Receipt	9,200,000		
Crown Lands	1,290,000	Total	371,560,000
Receipts from Sundry Loans	32,640,000		
Miscellaneous:		Total Ordinary Expenditure	700,964,000
Ordinary Receipts	10,433,000		
Special Receipts	25,932,000	NEW SINKING FUND, 1928	47,748,000
Total Ordinary Revenue	734,189,000		
SELF-BALANCING REVENUE AND EXPENDITURE		SELF-BALANCING REVENUE AND EXPENDITURE	
Post Office	58,900,000	Post Office	58,900,000
Road Fund	21,882,000	Road Fund	21,882,000
Total Self-Balancing Revenue and Expenditure	80,782,000	Total Self-Balancing Revenue and Expenditure	80,782,000
Grand Total	814,971,000	Grand Total	829,494,000

TABLE V

EXPENDITURE ON THE PUBLIC SOCIAL SERVICES 1891–1929[1]

TOTAL EXPENDITURE (OTHER THAN OUT OF LOANS FOR CAPITAL PURPOSES) DURING THE YEAR ENDED 31ST MARCH

Service	England and Wales					Scotland.					Great Britain 1929 (or latest available year)
	1891	1901	1911	1921	1929 (or latest available year)	1891	1901	1911	1921	1929 (or latest available year)	
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
(a) Unemployment Insurance Acts				9 701	47 487				1 067	6,351	53 848
(b) National Insurance (Health) Acts				26 370	35 967				3 487	3 928	39 895
(c) Widows Orphans and Old Age Contributory Pensions Acts					21 220					2 507	23 627
(d) Old Age Pensions Acts			6 300	18 325	30 953			1060	2,424	3 961	34 914
(e) War Pensions Acts and the Ministry of Pensions Act				90 924	48 474				10 025	5 484	53 958
(f) Education Acts	10 079	16 969	29 050	76 405	83 944	1409	2575	4439	12,383	13 084	97 028
(g) Acts relating to Reformatory and Industrial Schools	375	424	582	1 154	570	79	83	108	332	168	788
(h) Inebriates Acts		4	22	17				1	1		
(i) Public Health Acts so far as they relate to—											
(i) Hospitals and Treatment of Disease	410	1 330	1 850	7 310	7 132	32	241	381	1 245	1,338	8 470
(ii) Maternity and Child Welfare Work			Not ascertained	1 904	2,200				195	298	2 498
(j) Housing of the Working Classes Acts	238	410	747	4 240	27 482	4	134	141	453	4 160	31 642
(k) Acts relating to the Relief of the Poor	8 450	11 549	15 023	31 925	39 746	599	835	1135	2,335	4 190	43 936
(l) Unemployed Workmen Act			184	74	39			29	30	9	48
(m) Lunacy Acts	506	1 021	1 503	2,435	2 365	} 297	434	602	1 338	1 265	4 961
(n) Mental Deficiency Act				640	1 351						
Totals	20 125	31 707	55 251	271 425	348 930	2420	4308	7890	35 315	46 853	395 783

TABLE VI

SOURCES OF EXPENDITURE ON THE PUBLIC SOCIAL SERVICES[1]

YEAR ENDED 31ST MARCH 1929 (OR LATEST AVAILABLE YEAR)

Service.	England and Wales. Local Rates.	Parliamentary Votes and Grants.	Other Receipts (contributions, fees, interest, rents, etc.).	Total.	Scotland. Local Rates.	Parliamentary Votes and Grants.	Other Receipts (contributions, fees, interest, rents, etc.)	Total.
	£000	£000	£000	£000	£000	£000	£000	£000
(a) Unemployment Insurance Acts	..	10,701	36,774	47,475	..	1,310	5,049	6,359
(b) National Insurance (Health) Acts	..	6,873	28,347	35,220	..	757	3,335	4,092
(c) Widows', Orphans' and Old Age Contributory Pensions Acts	..	..	20,925	20,925	..	..	2,374	2,374
(d) Old Age Pensions Acts	..	30,953	..	30,953	..	3,981	..	3,961
(e) War Pensions Acts and the Ministry of Pensions Act	..	48,474	..	48,474	..	5,484	..	5,484
(f) Education Acts	35,595	41,397	6,952	83,944	5,268	6,755	1,081	13,084
(g) Acts relating to Reformatory and Industrial Schools	256	257	57	570	39	67	32	168
(h) Inebriates Acts	..	(1911) 22	..	22	..	(1911) 1	..	1
(i) Public Health Acts so far as they relate to—								
(i) Hospitals and Treatment of Disease	4,436	2,248	448	7,132	843	469	23	1,338
(ii) Maternity and Child Welfare Work	922	875	403	2,200	137	146	15	298
(j) Housing of the Working Classes Acts	2,121	10,025	15,336	37,482	776	1,368	2,018	4,160
(k) Acts relating to the Relief of the Poor	33,371	3,289	3,086	39,746	4,318	213	88	4,919
(l) Unemployed Workmen Act	8	..	31	39	3	..	6	9
(m) Lunacy Acts	997	232	1,136	2,365	928 (m and n together)	234	103	1,265
(n) Mental Deficiency Act	515	713	123	1,351				
Totals	75,221	156,037	113,618	347,876	12,642	20,764	14,105	47,511

[1] Parliamentary Return, December 4, 1930.

III

[I]MPERIAL TAXATION

[...] WITH THE EXCLUSION OF THE DEATH DUTIES, THE [...]E ENTERTAINMENTS DUTY—TO SPECIMEN INCOMES[1]

[...]nd to have 3 children under the age of 16

Total Taxation.	
[In]come [w]holly [Ea]rned	Incom[e] Earne[d] Invest[ment]
s d	£
7 0	4
12 3	6
16 0	8
11 2	12
2 10	32
11 8	76
1 4	147
13 4	375
16 8	758
3 4	1,527
3 4	3,987
0 6	4
7 6	6
9 2	8
17 10	10
0 10	35
0 10	82
15 10	168
4 2	477
17 6	1,177
4 2	2,587
4 2	6,767
17 6	11
7 0	15
16 6	18
17 0	67
8 6	205
9 6	560
9 6	1,959
16 6	4,633
16 6	10,451
16 6	29,122
1 9	15
8 8	21
11 9	25
16 9	49
17 9	169
10 9	429
10 9	1,629
11 9	4,297
11 9	10 277
11 9	30,300
17 6	12
9 3	19
7 9	22
2 4	42
5 4	144
19 0	386
0 0	1,477
1 0	4 007
1 0	9,745
1 0	23,863

Cocoa, Coffee, and Chicory, Dried Fruits, Patent Medicines, and Table Waters	Total Taxation. Income wholly Earned	Total Taxation. Income half Earned half Investment.	Total Taxation Percentage of Income. Income wholly Earned	Total Taxation Percentage of Income. Income half Earned half Investment
£ s d	£ s d	£ s d	%	%
0 1 0	1 6 0	1 6 0	2 6	2 6
0 2 0	1 10 8	1 10 8	1 6	1 5
0 3 0	1 17 0	1 17 0	1 2	1 2
0 4 0	8 18 2	8 13 2	2 0	2 0
0 4 0	18 19 10	18 19 10	3 8	3 8
0 4 0	50 10 8	50 10 8	5 1	5 1
0 4 0	98 2 4	98 2 4	4 9	4 9
0 4 0	239 17 4	239 17 4	4 8	4 8
0 4 0	475 0 8	475 0 8	4 8	4 8
0 4 0	946 7 4	946 7 4	4 7	4 7
0 4 0	2,348 7 4	2,348 7 4	4 7	4 7
0 1 0	0 19 6	0 19 6	1 9	1 9
0 2 0	1 2 6	1 2 6	1 1	1 1
0 3 0	1 9 2	1 9 2	1 0	1 0
0 4 0	2 0 10	2 5 0	1 0	1 1
0 4 0	14 10 10	19 16 0	2 9	4 0
0 4 0	41 15 10	68 4 2	4 2	5 2
0 4 0	81 0 10	101 17 6	4 1	6 1
0 4 0	301 19 2	301 19 2	6 0	6 0
0 4 0	774 12 6	774 12 6	7 7	7 7
0 4 0	1,620 19 2	1,620 19 2	8 1	8 1
0 4 0	4,147 19 2	4,147 19 2	8 6	6 8
0 10 0	4 12 0	4 12 0	4 6	4 6
0 11 6	6 9 0	6 9 0	3 6	3 6
0 14 0	6 2 0	6 2 0	3 0	6·0
0 15 0	40 16 6	50 4 0	8 2	10 0
0 16 0	155 1 6	176 16 6	16 6	17 4
0 16 0	460 11 6	498 1 6	28 0	24 9
0 15 0	1,802 6 6	1,802 6 6	36·0	36 0
0 15 0	4,208 6 6	4,208 6 6	42 1	42 1
0 15 0	9 471 6 6	9,471 6 6	47 4	47 4
0 15 0	25,248 6 6	25,248 6 6	50 5	50 5
0 8 8	4 19 8	4 19 8	6 0	6 0
0 9 0	5 14 8	5 14 8	3 8	6 8
0 9 9	6 6 9	6 6 9	3 2	3 2
0 10 6	22 2 9	24 19 0	4 4	5 0
0 10 6	115 2 9	126 7 9	11 5	12 6
0 10 6	319 17 9	342 7 9	16 0	17 1
0 10 6	1,361 12 9	1,361 12 9	27 2	27 2
0 10 6	3,592 12 9	3,592 12 9	35 9	35 9
0 10 6	6 355 12 9	6,355 12 9	41 6	41 8
0 10 6	23,882 12 9	23,882 12 9	47 6	47 8
0 6 0	2 14 6	2 14 6	2 7	2 7
0 6 6	3 2 8	3 2 3	2 1	2 1
0 6 9	3 4 9	3 4 9	1 6	1 6
0 6 9	13 10 4	17 13 8	2 7	3 5
0 6 9	84 10 4	101 3 8	8 5	10 1
0 6 9	267 17 0	284 10 4	13 4	14 2
0 6 9	1,099 2 0	1,099 2 0	22·0	22·0
0 6 9	2 999 2 0	2,999 2 0	30 0	30 0
0 6 9	7,374 2 0	7,374 2 0	36 9	36 9
0 6 9	22,124 2 0	22,124 2 0	44 2	44 2

[...] Income Tax are [...] [i]n regard to these d[...] [expen]diture All these [...] consumed."

[...] Debt and Taxation, p 96

[To face page 340.

TABLE IX

LOCAL AUTHORITIES RECEIPTS FROM RATES

1913-14 TO 1929-30

Year	England and Wales	Scotland
	£000	£000
1913-14	71,276	7,709
1918-19	84,703	9,333
1919-20	105,633	12,952
1920-21	151,809	18,129
1921-22	170,872	18,377
1922-23	157,274	17,266
1923-24	143,275	17,721
1924-25	141,977	18,072
1925-26	148,598	18,603
1926-27	159,000	20,506
1927-28	167,000	21,400
1928-29	166,000	
1929-30	168,000	

TABLE

EXPENDITURE OF THE LOCAL

ENGLAND

Services.	1913–14.	1018–19.	1919–20.	1920–21.
	£	£	£	£
Education:				
Elementary (including industrial schools)	14,093,692	10,073,139	20,112,953	26,104,334
Higher	2,474,341	2,967,627	4,504,476	5,767,010
Public libraries and museums .	620,081	672,059	846,897	1,270,754
Relief of the poor (excluding maintenance of lunatics in county and borough asylums)	10,651,873	12,977,229	17,125,385	22,833,441
Lunacy and mental deficiency .	2,820,258	3,607,729	4,610,584	6,137,832
Highways and bridges (excluding lighting but including scavenging)	15,525,490	14,133,688	21,110,923	31,198,142
Public lighting (lighting streets, etc.)	2,329,025	1,322,902	2,370,758	3,429,736
Public health	12,103,317	15,408,174	21,140,372	28,249,221
Housing and town planning . .	390,730	281,272	574,065	1,231,341
Fire brigades (engines, etc.) . .	730,582	979,724	1,292,636	1,716,529
Police and police stations . .	4,425,631	5,762,057	8,060,330	10,147,252
Administration of justice . .	650,014	420,561	428,104	621,936
Land drainage and river conservancy and embankment	358,376	313,663	449,274	586,774
Small holdings and allotments .	24,091	11,346	230,048	321,335
Trading services (*i.e. net* charge) .	*709,989* Cr.	*362,001* Cr.	1,978,731	5,555,645
Other services (including unallocated overhead charges)	10,482,039	12,488,356	18,376,051	16,083,432
Total (including sums entered against next item)	70,095,360	90,056,085	123,218,082	161,204,714
Deduct. Expenditure (so far as included above) met out of (i) grants under the Agricultural Rates Acts made in aid of rates, (ii) "free balances" of Exchequer Contribution Accounts applied in aid of rates, and (iii) miscellaneous receipts applied in aid of rates (not allocated to specific services)	6,709,000	6,775,250	9,720,135	7,429,856
Net expenditure falling to be met out of rates	70,285,394	83,281,726	113,491,947	153,774,858

X

AUTHORITIES MET FROM LOCAL RATES

AND WALES

1921 22	1922 23	1923–24	1924 25	1925–26	1926–27	1927 28
£	£	£	£	£	£	£
26 636 838	26 836 165	24 292 591	25 350 989	26 196 637	26 589 044	26 011 643
6 226 140	6 416 723	6 814 161	6,288 797	6 712 193	6 998 231	7 407 018
1 321 122	1 282 468	1 314 765	1 387 537	1 462 303	1 646 300	1 605 062
82 163 609	32 997 039	29 723 138	28 662 104	31 676 711	40 629 628	31 340 653
6 416 243	* 6 736 363	5 663 685	5 826 644	5 964 188	6 236 458	6 186 319
80 167 683	28 169 463	27 930 391	30 609 251	82 160 070	82 862 732	38 740 118
3 666 666	3 666 607	3 550 493	3 663 608	3 841 886	8 820 86	4 067 427
27 873 422	24 728 876	24 271 638	25 196 057	25 849 844	2 006 309	27 547 323
1 106 836	863 287	836 486	1 286 096	1 716 267	2 304 616	2 834,221
1 768 648	1 646 678	1 706 237	1 770 666	1 821 777	1 866 242	1 924 961
10 626,231	8 631 048	8 789 898	9 033 649	9 574 187	10 053 944	10 2 4 766
748 158	678 140	627 606	622 78°	668 029	637 908	638 668
659 268	582 469	628 811	671 871	627 764	639 627	721 604
149 362	*4 427* Cr	7 698	2,763	1 808	*128 671* Cr	*50,289* Cr
6 667 100	*4 835,577* Cr	*2 029 046* Cr	*1,179,839* Cr	*849,329* Cr	2 889 246	*2 785,260* Cr
16 007 638	14 207 184	13 910 989	14 084 144	14 241 787	14 609 113	16 133 482
169 473 738	160 678 746	146 929 824	153 077 108	161 624 621	177 669 501	166 137 616
7 910 794	7 385 806	9 897 612	10 703 508	12 115 866	12 093 509	12 706 680
161 662 944	143 192 941	137 031 712	142 373 600	149 508 666	166 466 992	163 432 027

TABLE

EXPENDITURE OF THE LOCAL

ENGLAND

Services.	1913–14.	1915–16.	1916–17.	1917–18.	1918–19.	1919–20.
	£	£	£	£	£	£
GRANTS IN AID OF THE COST OF SPECIFIED SERVICES:						
Education:						
Elementary - (including Industrial Schools)	11,779,920	12,443,378	12,267,861	15,415,164	16,170,729	25,679,807
Higher . .	2,180,416	2,214,773	2,153,185	2,431,014	2,593,449	6,624,715
Public Health .	356,747	561,862	573,503	799,257	1,014,776	1,507,837
Lunacy and Mental Deficiency	955,422	1,051,477	1,114,711	1,074,673	1,085,597	1,191,650
Housing . .	..	..	63,780	..	709	2,732
Relief of the Poor (excluding Maintenance of Lunatics in County and Borough Asylums)	1,058,175	955,869	1,077,650	1,049,650	1,052,672	1,070,762
Highways and Bridges	576,268	420,962	283,840	191,065	197,745	3,166,304
Police and Police Stations	2,871,902	2,949,090	2,881,667	2,957,296	4,060,529	6,417,392
Small Holdings and Allotments	52,286	32,227	9,414	4,093	5,254	51,497
Land Drainage and River Conservancy and Embankment	..	..	..	..	..	61,233
Other Grant-aided Services	189,618	183,653	224,433	214,014	458,809	610,267
GRANTS IN RELIEF OF RATES (not directly allocated to Specified Services):						
Grants under the Agricultural Rates Acts, 1896 and 1923, so far as not included above	1,210,386	1,203,418	1,203,139	1,203,102	1,202,780	1,202,391
Free Balances of Exchequer Contribution Accounts	1,288,659	1,144,560	1,075,840	1,057,836	1,103,150	1,182,117
Total . .	22,519,709	23,170,269	22,929,023	26,307,161	28,946,196	47,968,704

NOTE.—Following the Act of 1929 (see Chapter XVI) the Government Grants to for 1930–31 were estimated to be £44,507,000,

XI

AUTHORITIES MET FROM GOVERNMENT GRANTS

AND WALES

1920–21	1921 22	1922 23	1923 24	1924 25	1925–26	1926–27	1927 28
£	£	£	£	£	£	£	£
32 933 577	35 687 505	32 914 444	32 753 845	32,458 195	32,514 562	33 388 012	32 845 300
6 289 156	7 180 058	6 262 348	5 090 657	6,218 827	6 532 729	6 410 054	6 825 685
2 738 183	4,223 104	3 434 569	6 259 876	3 429 334	3 702 195	3 886 935	4 026 693
1,273,234	1 431 671	1 415 745	1 419 889	1 431 754	1 533 771	1 583 668	1 640 475
775 049	4 733 285	7 085 124	7 449 465	7 490 017	7 859 804	8 545 684	9 874 922
1 077 487	1 180 176	1 154,277	1 152 307	1 199 435	1 209 591	1,204 259	1,250 065
4 595 455	8 800 878	9 764 808	10 977 863	12 975 104	13 988 188	18 895 680	15 029 771
9 494 565	9 415 254	5 574 278	8 569 802	9 094 626	9 585 050	10 156 558	10 062 151
552 407	654 450	528 527	855 483	844 207	995 400	914 981	905 351
49,309	55 731	116 925	117 995	57 932	57 170	60 898	70 824
88 021	721 900	514 995	771 637	868 784	949 751	1 034 532	897 294
1 208 579	1 130 722	1 135 572	6 075 668	3 244 543	3 841 175	3 541 879	3 603 363
1 306 623	1 306 706	1 712 578	1 806 197	2 119 168	2,392 069	2 349 118	2 900 494
63 076 605	76 529 940	75 514 190	78 699 384	81 431 626	84 683 433	55 953 508	89 933 399

Local Authorities have considerably increased The New Exchequer Contributions bringing the total Grants to £160 821 000

TABLE XII

IMPERIAL TAX REVENUE, 1915–16 TO 1928-29 REDUCED TO PRE-WAR VALUES ON THE BASIS OF THE COST OF LIVING INDEX FIGURE[1]

		1913–14.	1914–15.	1915–16.	1916–17.	1917–18.	1918–19.	1919–20.	1920–21.	1921–22.	1922–23.	1923–24.	1924–25.	1925–26.	1926–27.	1927–28.	1928–29.
		£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Customs and Excise . .	Actual .	75	81	121	127	110	162	283	334	324	280	268	234	238	240	251	258
	Pre-war value	..	..	93	82	60	77	130	131	150	156	154	134	187	140	151	153
Motor Vehicle Duties . .	Actual .	..	..	..	..	..	..	..	7	11	12	15	15	18	21	25	25
	Pre-war value	..	..	..	..	..	..	..	3	5	7	8	9	10	12	15	15
Inland Revenue exclud. E.P.D.	Actual .	88	108	169	247	283	337	426	472	401	480	435	438	420	398	418	400
	Pre-war value	..	..	131	159	155	159	195	185	230	268	250	251	240	231	252	245
E.P.D. . .	Actual .	..	..	..	140	220	285	200	210	30	2	..	1	2	5	..	1
	Pre-war value	..	..	..	90	120	135	133	86	15	1	..	..	1	3	..	1
Total Tax Revenue . .	Actual .	163	189	290	514	613	784	909	1032	857	775	718	688	685	664	693	685
	Pre-war value	..	..	224	330	335	371	458	405	412	432	418	394	394	386	418	414
Average cost of living index figure for financial year . .	..	..	Incomplete	129·4	165·7	182·8	211·4	218·2	254·8	207·8	176·3	173·0	175·1	173·8	172·0	165·8	165·5

[1] Reproduced, by permission, from *British Budgets, 1913–14 to 1920–21*, by Sir Bernard Mallet and Mr C. O. George.
The table shows that, although the nominal tax revenue increased from £163 millions in 1913–14 to £1032 millions in 1920–21, an apparent increase of over 500 per cent, the real increase, when reduced to a common basis of purchasing power, was about 150 per cent. Similarly, though the money revenue for 1920–21 appears to be at the peak, it was exceeded in real value in 1919–20, and has also been surpassed in the last few years.

SELECT BIBLIOGRAPHY

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INDEX

INDEX

THE END

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